

CONSUMPTION TAXATION & ELECTRONIC COMMERCE:
ISSUES, APPROACHES AND A WAY FORWARD

By

KONSTANTINOS SILIAFIS

2015

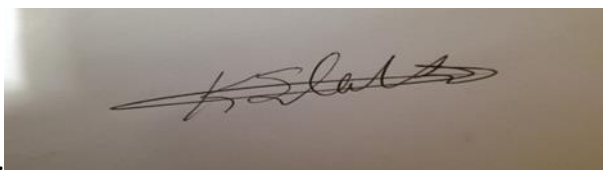
Thesis submitted for the Degree of Doctor of Philosophy in Law at the University of
Aberystwyth.

Department of Law & Criminology

June 2015

DECLARATION

This work has not previously been accepted in substance for any degree and is not being
concurrently submitted in candidature for any degree.



Signed (candidate)

Date26th June 2015.....

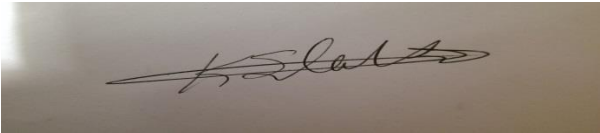
STATEMENT 1

This thesis is the result of my own investigations, except where otherwise stated.

Where correction services have been used, the extent and nature of the correction is clearly marked in a footnote(s).

Other sources are acknowledged by footnotes giving explicit references.

A bibliography is appended.

Signed  (candidate)

Date 26th June 2015.....

STATEMENT 2

I hereby give consent for my thesis, if accepted, to be available for photocopying and for inter-library loan, and for the title and summary to be made available to outside organisations.

Signed  (candidate)

Date 26th June 2015.....

Abstract

Internet and the development of electronic commerce transformed the nature of commercial activities. It also created significant challenges to taxation principles and the relevant authorities. This thesis is taking the approach that electronic commerce should be subject to taxation, because despite the unique characteristics it is nonetheless a commercial activity. New methods of delivery and digitisation of products raise particular problems for principles of consumption tax and for governments failing to utilise their tax policies for collecting revenue to subsequently fund welfare initiatives and the public sector. This thesis will identify and analyse the challenges presented, as well as examine the current regulatory approaches, whether they are primary legislative measures or merely “soft law”. The two major actors in this area are currently the European Union and the United States; however the approaches between the two have been distinctly different. Originally an official “moderator” was not established, which drove the OECD to assume the role in an informal capacity. The US did initially take a “hands off” approach in relation to electronic commerce taxation and did not implement any such legislation at a Federal level. This ended up causing problems to online vendors and consumers. However with initiatives such as the Streamline Sales and Use Tax Agreement as well as the Marketplace Fairness Act, the US is slowly taking more active steps to engage the ongoing developments. On the other side, the EU

begun from a different perspective to the US. EU made significant and numerous attempts to regulate consumption taxes on online sales. The initiative shown by the EU and the nature of the European Single Market meant that the Member States started operating on a basis of close cooperation with each other in relation to electronic commerce activities and taxation earlier than US States. The new EU rules coming into operation from January 2015 identify the point of consumption as the point where tax is to be levied and indicates a dynamic European approach, one which could be establishing an efficient precedent and potentially followed by many other non-EU jurisdictions. This thesis will support the idea for a harmonisation of the tax principles relating to consumption taxation. Harmonisation can be seen as a problem in itself due to being a rather complex procedure, which becomes more complicated in regards to consumption taxation, especially taking into consideration that taxation can be indicative as a sovereign aspect of a State. The OECD guidelines on Electronic Commerce Taxation in 1998 have set the groundwork in the area and established general directions for States. Currently there is a seemingly similar direction EU and the US are heading to, which may indicate the possibility of a harmonised consumption taxation system between EU, the US and other participating jurisdictions being perhaps less of a regulatory utopia. A harmonised tax system for electronic commerce could promote further development of a more efficient commercial, as well as a more enriched socio-political reality.

Contents

Abstract	5
Contents	7
1. Introduction.....	12
1. Introduction	14
2. The Hypothesis.....	16
3. Contribution to the debate	18
4. Theory on regulation on the Internet	22
5. Methodology.....	31
6. So what are the main issues?.....	32
6.1 Current initiatives.....	38
7. Structure	46
Chapter 2.....	46

Chapter 3.....	47
Chapter 4.....	47
Chapter 5.....	48
Chapter 6.....	48
Chapter 7.....	49
2. Electronic commerce and challenges to taxation.....	50
1. Introduction	54
2. What is electronic commerce?	59
3. Should electronic commerce be taxed?.....	65
3.1 One set of rules or “real” & “virtual” rules separately?	69
3.2 Cyber-libertarianism	71
3.3 Neutrality	73
4. Challenges electronic commerce poses for taxation	74
4.1 Jurisdictional matters.....	75
4.2 Anonymity.....	78
4.3 Determining Place of Supply; the importance of Permanent Establishment	80
4.4 Digitization; Goods or services?	81
4.5 Dominance by a few players	82
5. Specific challenges electronic commerce presents to taxes.....	85
5.1 To Income Tax	86
5.2 To VAT	88
6. Conclusion	97
3. Taxation: the ‘Smithsonian canons’, key elements and the Internet.....	98
1. Introduction	102
2. What is tax?.....	103
3. Taxation: a historic glimpse into its origins and development	108
4. Why tax?	114
4.1 How to tax? Adam Smith and the ‘4 canons’	116
5. Direct and Indirect taxation	131
6. Permanent Establishment.....	138

7. Consumption taxation.....	141
8. Origin and Destination principles.....	143
9. Conclusion.....	145
4. Reacting to the challenges of electronic commerce taxing; “soft law” and the US.....	147
1. Introduction	151
2. Soft Law.....	152
2.1 WTO	153
2.2 OECD	155
2.3 1998 Ottawa Taxation Framework	157
2.4 OECD and tax collection.....	169
2.5 2006 VAT Guidelines	172
3. The approach in the US.....	174
3.1 US case law.....	179
3.2 Clinton Administration.....	180
3.3 Internet Tax Freedom Act	182
3.4 Streamline Sales Tax Project and Streamlined Sales and Use Tax Agreement.....	188
3.5 Marketplace Fairness Act.....	192
4. Conclusion.....	194
5. The approach of the European Union.....	197
1. Introduction	200
2. EU specific developments relevant to taxing electronic commerce.....	202
2.1 Relevant background	203
2.2 6th VAT Directive	214
2.3 Current initiatives.....	222
3. Is EU being efficient?.....	236
3.1 EU Directive: a good thing?.....	238
3.2 What next? Opportunities or retaliation? The Regulation (EU) No 1042/2013	247
4. Conclusion.....	251

6. Discussions on Efficiency, Vat & Sales Tax 255

1. Introduction	259
2. Are the current initiatives going to the same direction?	260
2.1 VAT and Retail Sales Tax; or VAT vs. Retail Sales tax?	262
2.2 Theoretical Responses	263
2.3 Regulatory Responses	267
2.4 Does VAT mean better cooperation and efficiency?	268
2.4 Is VAT the better option?	269
3. Conclusion	273

7. Consumption Tax principles and cooperation..... 274

1. Introduction	276
2. Should the aim be harmonisation of the tax principles?	278
3. Harmonisation does not mean Unification	280
3.1 What is harmonisation?	282
3.2 Why harmonise?	285
3.3 Why not harmonise?	292
4. Maybe cooperation a better solution for the near future?	295
5. Conclusion	297

8. Conclusion 299

1. Summary of main points	301
2. Regulation; significant attempts so far	304
3. Policy and action for the future?	306

Bibliography 310

Books	310
Journal articles	313
Other sources	331

1. Introduction

Table of Contents

1. Introduction.....	12
1. Introduction	14
2. The Hypothesis.....	16
3. Contribution to the debate	18
4. Theory on regulation on the Internet	22
5. Methodology.....	31
6. So what are the main issues?.....	32
6.1 Current initiatives.....	38
7. Structure	46
Chapter 2.....	46
Chapter 3.....	47
Chapter 4.....	47
Chapter 5.....	48
Chapter 6.....	48
Chapter 7.....	49

1. Introduction

*'The greatest challenge to a tax regime is its ability to adjust and adapt to a changing world. The coming of the age of electronic commerce, the increased mobility it brings to business, and the greater flexibility it offers to the way that transactions and communications are made is the latest and perhaps the most demanding of these challenges'*¹

New developments, especially when they are related to technological advancements,

¹ "Establishing a Framework to Evaluate Electronic commerce Tax Policy Options", Deloitte & Touche and UC Berkeley, 1999

are pushing boundaries and potentially changing the landscape of the area. Information technology has made significant steps over the last few decades and with that came dramatic changes in the legal and commercial world. The technological and social progress that came with the development of the Internet presents major changes in the way a developed nation and its citizens are conducting their activities online. Along with the Internet came electronic commerce and revolutionised the way commerce is done both for the seller and the consumer. Unprecedented tax issues flowing from electronic commerce created a new agenda for an online tax regime. The Internet has unleashed the creative genius of countless entrepreneurs and has enabled the creation of jobs; it has enabled small businesses to reach a global market and it allowed for the expansion of large ones to a wider global consumer base, thus significantly increasing the number of consumers and sellers operating on the electronic commerce platform.

This thesis will explore the implications of the relationship between electronic commerce and taxation, especially focusing on consumption taxes. It is an intriguing relationship which poses some exciting questions and challenges for the regulatory authorities, when the states are faced with such challenges. This thesis examines the various proposals and responses to the challenging landscape of electronic commerce taxation, especially consumption taxation where VAT will be demonstrated as better

fitting and more efficient. In the end a proposal will be presented as a hopeful model for a better structured and efficient system.

2. The Hypothesis

This thesis is examining the principles behind the relationship of online commerce and consumption taxation. The hypothesis of this research is that electronic commerce should be subject to taxation, as it is a commercial activity. However, there needs to be an evaluation of the best methods and initiatives and harmonisation should be given some serious thought as a likely preferred approach forward, in the same way that VAT seems the better option for a fitting tax. To the question posed by Basu, “to tax or not to tax? That is the question”² the answer is of course that electronic commerce needs to be taxed. If it remains untaxed or taxed incorrectly, there will be significant implications for the states due to the increasing value of electronic commerce transactions, and the overall economic implications.

Electronic commerce has been around for long enough for the relevant authorities to be able to comprehend and impose taxation on it; it is not new anymore to warrant a

² Basu S, (2004) “To tax or not to tax? That is the question. Overview of options in consumption taxation of electronic commerce”, (1) The Journal of Information, Law and Technology, JILT http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu/

“hands-off” approach.³ However, taxation principles are traditionally rather rigid and not easily adaptable, especially when faced with a different commercial reality, which e-commerce presents. The thesis will be examining the relationship VAT and consumption taxes have with e-commerce. Due to the nature of the Internet and its lack of boundaries it can raise a number of legal concerns when looked at from a tax and commercial perspective, especially for the authorities. The regulatory authorities may need to face certain challenges going to the centre of the debate. The emphasis could be looking into the actual transaction, which can either be characterised as good or as service, something dependent on the different approaches taken by different States to tax based on the place of supply or the place of consumption.

This research deals with electronic commerce and taxation, and the interaction of the two. It is trying to examine the problems arising from that relationship and whether there can be a way to resolve them or facilitate easier transactions online, for customers and online traders as well as governments. So the important question raised is how does e-commerce interact with the relevant consumption taxation principles and how should it be taxed?

³ Kenny, C. (2003) The Internet and economic growth in less-developed Countries: A case of managing expectations?. Oxford Development Studies, 31(1), 99-113.

This analysis will examine general issues raised as far as taxation is concerned, but the main focus will be on consumption taxation, VAT in EU and Retail Sales tax in the US. Online vendors are taking advantage of the Internet to acquire new customers from all over the globe, which is great as it enhances commerce and allows customers to purchase an item or service regardless of where they are based. However this expansion does create consumption tax complications, which need to effectively be considered and addressed. There is the argument⁴ that B2B transactions concern parties who are interested in professional and commercial honesty with the tax authorities. This would mean no negative implications for either parties, especially considering the larger sums of money and often the necessity of certain documentation to keep a trail of transactions. For B2C transactions, the value is usually significantly lower than B2B transactions online, and the parties involved, especially the consumer, will not be especially interested in tax honesty, even more if that means a more attractive price.

3. Contribution to the debate

The literature on this topic has been slightly inconsistent in its perspective and findings. Many times deductive reasoning had to be used in order to assess whether a traditional

⁴ Clayton W. Chan (2000) Taxation of Global E-Commerce On the Internet: The Underlying Issues and Proposed Plans 9 Minn. J. Global Trade 233

concept of commerce would fit with electronic commerce. This can then be taken further and re-applied to electronic commerce but this time trying to fit it the same “space” as taxation. There was substantial amount of research in this area, especially from 90s onwards. However, there was very little organised state action in this area before 2010,⁵ therefore literature appeared slightly less enthusiastic, with exceptions of some academic writing from UK and the US. The basis of state action was concentrating on the US Internet Tax Freedom Act and the EU implementation of 2002/38/EC. The contribution of this thesis lies in adding to the area with an up-to-date examination of the contemporary regulatory frameworks and filling in the gaps. It also extends to proposing and evaluating harmonisation as a potential fitting global framework relating to consumption taxation of e-commerce.

Due to the significance of the topic in discussion, both OECD⁶ and WTO⁷ attempted to take positions and provide guidance to the challenges raised. Following these initiatives, academics joined the enthusiasm, arguing the matter from a different point, from cyber libertarians to cyber sceptics. John Barlow, issuing the Declaration of Independence of Cyberspace has been a constant voice against regulation imposed on the Internet. He

⁵ Pastukhov, O. (2009). Going Where No Taxman Has Previously Gone: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on International Taxation of Electronic Commerce, 36 Rutgers Computer and Technology Law Journal, pp. 1-15.

⁶ OECD, Ministerial Conference on Electronic Commerce, 1999, <http://www.oecd.org/sti/ieconomy/forumbackgroundtheottawaconference.htm>

⁷ World Trade Organization, Ministerial Declaration of 18 December, 2005, 46, WT/MIN(05)/DEC, http://www.wto.org/english/thewto_e/minist_e/min05_e/final_annex_e.htm

advocates via the Electronic Frontier Foundation⁸, a non-profit organisation that for years have been at the forefront of defending rights in the online environment and examining closely the interaction between law and technology. From EFF, Pamela Samuelson is also a notable speaker for freedom and less regulation online. Even in other areas, Cyber-scepticism at the other end of the spectrum, with the prevalent idea that cyberspace should be controlled more and better and that is to protect ourselves. A couple of contemporary cyber sceptics, namely Evgeny Morozov and Molcolm Gladwell, both being writers and journalists who did not support strict and frame-worked regulations, have indicated that regulation seems the correct choice. Even in other areas such as in the area of sociology, a contemporary cyber-sceptic, Professor Sherry Turkle strongly advocates against technology and the information age. He is arguing that both technology and information age dehumanise any interaction and create a cyber-reality imitating parts of real world⁹. Cyber libertarians, in line with classic libertarian thinking, are marked by a distaste for government and faith in market regulation¹⁰. Most of them are the writers who claimed the Internet was a medium, which would prove to be extremely difficult or impossible to control due to its nature to transcended geographical borders and built in anonymity. They also advocated the Internet as a space of freedom, a bringer of the benefits of liberty, free speech and democracy.

⁸ <https://www.eff.org/>

⁹ Sherry Turkle (2011) *Alone Together: Why We Expect More from Technology and Less from Each Other*, Basic Books

¹⁰ Bomse (2001) *The Dependence of Cyberspace*, Duke Law Journal, Vol 50;1717

Cyber-realism is identifying the need for regulation; however it also appreciates the individuality of the Internet. Professor Lawrence Lessig in his book “Code and Other Laws of Cyberspace” written in 1999 understood the cyber libertarianism principles, but he observed that certain things could better regulate behaviour online, namely Law, Markets, Code and Norms¹¹. Lessig argued that all these things regulate behaviour online and that regulation is sum of these factors just as they are in real space, but in cyberspace it is Code that is the main force.

Questions were raised and debated, varying from who should be responsible for regulation, how would the regulation operate and similar fundamental questions. Such debate had two opposing sides, the cyber-libertarians, arguing for self-regulation on the internet and no interference by the state¹² and the cyber-sceptics, who were extremely critical of such freedom online, viewing it as almost an online anarchy.¹³ This thesis’s contribution will be to put together the literature available and add to that body of

¹¹ Lessig (261) Code: And Other Laws of Cyberspace, Version 2.0 , Basic Books

¹² Llewellyn Joseph Gibbons, No Regulation, Government Regulation, or Self-Regulation: Social Enforcement or Social Contracting for Governance in Cyberspace, 6 CORNELLJ.L. & PUB.POL’Y475 (1997); I. Trotter Hardy, The Proper Legal Regime for “Cyberspace,” 55 U. PITT. L.REV. 993 (1994); Johnson & Post, supranote 17; Henry H. Perritt, Jr., Cyberspace Self-Government: Town Hall Democracy or Rediscovered Royalism?, 12 BERKELEYTECH. L.J. 413(1997)

¹³ Jack Goldsmith, Against Cyberanarchy, 65 U. CHI. L. REV. 1199 (1998); Jack Goldsmith, The Internet and the Abiding Significance of Territorial Sovereignty, 5 IND. J. GLOBALLEGALSTUD.475(1998); John Rothchild, Protecting the Digital Consumer: The Limits of Cyberspace Utopianism, 74IND. L.J. 893 (1999); Timothy S. Wu, Cyberspace Sovereignty? The Internet and the International System, 10 HARV. J. L. & TECH. 647 (1997)

knowledge.¹⁴ It will also look into the difference of e-commerce in order to get a better understanding of the difference of e-commerce.

4. Theory on regulation on the Internet

The Internet is considered by some authors as a place¹⁵, whereas a more realistic approach, as the one from Hedley¹⁶, is that it is a world-wide public access network of computers. That so called “place” had attracted a significant amount of intellect in regards to its characteristics. The major discussion was in regards to whether it can be regulated, whether Internet or Cyberspace can be controlled. The two major trends here were represented by two groups of theorists. On one side, the more traditional academics like Mckendrick¹⁷ and Kohl¹⁸ and Rowland¹⁹ simply arguing that there’s nothing new, just a different set of circumstances that can be identified with some laws

¹⁴ Arthur J. CORDELL ET AL., THE NEW WEALTH OF NATIONS: TAXING CYBERSPACE(1997); Reuven S. Avi-Yonah, International Taxation of Electronic Commerce, 52TAX L. REV. 507 (1997); Arthur J. Cockfield, Balancing National Interests in the Taxation of Electronic Commerce Business Profits, 74 TuL. L. REV. 133 (1999); RICHARD DOERNBERG, Luc HINNEKENS, WALTER HELLERSTEIN & JINYAN Li, ELECTRONIC COMMERCE AND MULTIJURISDICTIONAL TAXATION (2001); David R. Tillinghast, The Impact of the Internet on the Taxation of Informational Transactions, 50 BULL. INT’L FISC. DOC’N. 524 (1996); see also Subhajit Basu, To Tax or Not to Tax? That is the Question? Overview of Options in Consumption Taxation of Electronic commerce, 1 J. INFO., L. & TECH. (2004),

¹⁵ See Lemley, (2003) Place and cyberspace, 91 Calif LR 521

¹⁶ Hedley, (2006) The Law of Electronic Commerce and the Internet in the UK and Ireland, Cavendish

¹⁷ Computers and the law – New principles or the same principles in a different context?, SCL lecture, 2004

¹⁸ Kohl, (1999) Legal Reasoning and Legal Change in the Age of the Internet – Why the Ground Rules are still Valid 7(2) International Journal of Law and Information Technology, pp123-151, Available at <http://ijlit.oxfordjournals.org/content/7/2/123.full.pdf> 1999

¹⁹ Rowland D, (1998) 'Cyberspace - A Contemporary Utopia?', (3) The Journal of Information, Law and Technology (JILT), available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/1998_3/rowland/

already in existence, or we can even regulate some of the very new and unprecedented situations. On the other hand, the cyber-libertarians are one of the major influences in the area with notable theorists such as Kevin Baxton, the co-founder of Electronic Frontier Foundation,²⁰ as well as Barlow who was already mentioned and claimed that Cyberspace should and could simply declare independence from jurisdictions and regulation²¹. Also, there may be a claim for some people just being in between the two approaches; for example Professor Lessig does not say Internet is or should be left free and unregulated, but at the same time he is not very keen on overregulation and halting the potential²². Some authors, for example McIntyre-O'Brien, also consider cyberspace a unique "animal", which simply cannot be treated in the same jurisdictional manner as other types of law.²³

The Internet is an opportunity and a challenge of the 21st century. It is an opportunity for electronic commerce to develop and by that it presents a challenge to the state, international order, and the law.²⁴ Electronic commerce takes many different forms including negotiating contracts, advertising, marketing, on-line payment and settlement,

²⁰ <https://www.eff.org/>

²¹ A declaration of the independence of cyberspace, 1996, Available at <https://projects.eff.org/~barlow/Declaration-Final.html>

²² Lessig, (1998) The laws of Cyberspace, , available at http://cyber.law.harvard.edu/works/lessig/laws_cyberspace.pdf

²³ McIntyre-O'Brien, R, (2001) Is there such a thing as Cyberlaw'? (2003) 11 ISLR 118. 118 (a reply to it was by Bomse, The dependence of cyberspace, 50 Duke LJ 1717)

²⁴ Kenneth Kraemer et al., (2006)GLOBAL ELECTRONIC COMMERCE: IMPACTS OF NATIONAL ENVIRONMENT AND POLICY

on-line delivery of goods and services, and auctions. Increasingly, as mentioned above, businesses are looking at the opportunities of supplying goods and services through the Internet. The music and book trade amount to a large volume in this way. E-banking and financial services are available in cyberspace. Stock-broking firms provide on-line trading facilities. On the Web, potential customers are given product information and they can then place orders on-line. Payments can be made on- or off-line and products are delivered physically as well as in an intangible form.

This research will be looking into characteristics and functionality of aspects of the Internet and e-commerce and analyse the complex nature of online commercial activity and taxation. There is more than one issue to be considered, separately and then as different parts of the same equation. For a discussion of this nature to be able to reach some useful conclusions, there has to be not just one research path, but more running alongside. There is literature²⁵ already looking at specifically imposing taxation on electronic commerce activities, but that literature is not developed to a great extent yet mainly because of the relatively contemporary nature of the topic and the complexities it carries. For that reason, the research should also be directed towards literature strictly looking at taxation, literature specialized on electronic commerce nature and

²⁵ See Avi-Yonah, R. S. (1996). International taxation of electronic commerce. *Tax L. Rev.*, 52, 507. McLure Jr, C. E. (1996). Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws. *Tax L. Rev.*, 52, 269. Hellerstein, W. (1996). State Taxation of Electronic Commerce. *Tax L. Rev.*, 52, 425.

characteristics, and also on the issue of regulation generally. From these different “paths” it will be an intriguing and challenging exercise to extract the information that can be then linked to the main topic. So far, as happens at many instances with electronic commerce regulation, the ground rules are deemed applicable still²⁶ and that can be useful or can also create problems. Regarding tax rules, a careful consideration of the basic mechanisms and the rules regarding international taxation are going to provide useful insight into them attempting to identify the connection of same or similar rules with regard to electronic commerce activities.

Looking at literature on regulation in a legal context will be an extremely resourceful in terms of being able to distinguish a pattern of creating and adapting regulation in different or changing circumstances, which Cyberspace can certainly claim it is. A good example is Ogus,²⁷ where he attempts to find the reasons behind regulation by bodies such as governments, and what factors ultimately shape the regulatory patterns and models, looking at different regulatory models and their shortcomings. Also an interesting part in his discussion is that he provides some historical background in the development of regulation in UK, especially in times when a new and challenging situation arose, like now it is the issue of cyberspace and commercial activities online.

²⁶ Kohl, (1999) Legal Reasoning and Legal Change in the Age of the Internet – Why the Ground Rules are still Valid 7(2) International Journal of Law and Information Technology, pp123-151, Available at <http://ijlit.oxfordjournals.org/content/7/2/123.full.pdf>1999

²⁷ A. Ogus (1994) Regulation – legal form and economic theory, , Hart,

Chris Reed and John Angel also provide a more specialized analysis into regulation of information technology and surrounding issues²⁸. Murray goes even further and examines the development and design of structures to regulate the online environment²⁹. He considers different types of control, traditional and more radical, and draws on other opinions too to propose a rather complex model, which he acknowledges. But the significance of his attempt to examine how control works or should work in the online environment gives an initial structure upon other regulatory frameworks, which taxation systems could be based upon. Considering Murray's discussion one has to look at regulation of the internet and more specifically consumption taxation. To adequately regulate such an area, first there should be identification of the regulatory constraints and potential conflicts.³⁰ Modern regulatory environments are rather complex and therefore need careful consideration of any external elements as well as internal principles which may participate in the process. One theorist who attempted to provide a regulatory system was biologist Ludwig von Bertalanffy³¹, who emphasized that complex systems actually are open to and interact with their environments. This is a good system theory to transfer to the Internet, it being such a complex environment. Following from this initial theory, other followed with similar premise and more recently Mark Thacher attempted to reevaluate this

²⁸ Reed & Angel, (2007) Computer law : the law and regulation of information technology, OUP Oxford , 6th ed,

²⁹ Murray (2007) The regulation of cyberspace, Routledge-Cavendish

³⁰ Murray (2007) The regulation of cyberspace, Routledge-Cavendish, Ch 2

³¹ Bertalanffy (1968) General system theory: foundations, development, applications, Harmondsworth, Penguin

model and provide one that offers a simplified environment, thus easier to regulate upon³². Another theorist mentioned previously, Lessig, suggests that there are the internal and external aspects in a regulatory system but he insists on the four factors he identified as equally influential and important to regulation.³³ In this thesis what I hope to illustrate is that the current frameworks are identifiable within the theoretical backgrounds and also to highlight that to provide a good regulatory response to Internet and its aspects, such as e-commerce, that response should consider not only the legal, or the technological or the social factors, but all together with the added factor of the unique nature of the Internet itself.

Taxation on the other hand is a bit more perplexing as a topic; so it becomes even more complicated trying to evaluate whether taxation can be imposed on a “place” such as Cyberspace that lacks the thing taxation is based on, residence and establishment of the location of each of the parties. Therefore it seems difficult trying to establish a successful and efficient tax system that will be fully functional and will not create problems to the nature of cyberspace. Morse and Williams are rather concise in presenting the basic principles of taxation including the statutes and case law, and

³² Thacher (2000) Explaining Regulation Day 1 sessions 4 and 5, Short Course on Regulation, LSE, 11-15 Sept 2000

³³ Lessig, (1998) The laws of Cyberspace, , available at http://cyber.law.harvard.edu/works/lessig/laws_cyberspace.pdf

having a more than adequate section on VAT for both the European Union and the UK.³⁴

For more detailed discussion Lamb, Lymer, Freedman and James provide a very good account of Taxation essays³⁵, also including more than one perspective. One of these perspectives, for instance, is examining interdisciplinary approaches to taxation issues, something very beneficial for a research project looking at electronic commerce, which is so multidimensional.

The nature of cyberspace is borderless, so a model that would be efficient needs to encompass numerous jurisdictions and take into consideration differences in tax systems and tax administration. For that reason there is a clear need to consider principles of international tax and systems already in place in order to identify elements useful for electronic commerce taxation. Ogley provides an elaborate analysis of these principles³⁶, taking a realistic perspective and looking at the actual problems international tax systems face. By being so practical though, he is not dealing in depth with tax havens and tax avoidance practices. In areas where he fails to address, Lymer and Hasseldine manage to fill in the gaps³⁷. They provide a good analysis on the tax system and international tax treaties in place, but one thing about the book is that they are very US-centred. That means they provide opinions and arguments only specific to

³⁴ Davies (2004) Principles of tax law. Sweet & Maxwell; 6th ed .

³⁵ Lamb, Lymer Freedman and James ,(2005) Taxation, OUP

³⁶ Ogley, Principles of International Tax, Interfisc Publishing 1996

³⁷ Lymer & Hasseldine, The international Taxation System, 2005, Kluwer

sales tax, not VAT, and they approach the discussion from a more State level, rather than a federal united level, which would be more suitable for the EU system. The view they adopt in regard to internet posing a challenge to tax systems, is that there should only be minimal alterations to ground rules, and that most should apply directly as is, a view which currently is a lot stricter than the majority of US academics on this issue advocating the freedom and “special” character of the cyberspace. What Murray does agree with, at least in part of his work, is Professor Lessig’s theory on Control mechanisms for the online environment³⁸.

Lessig argues that control can happen and can be effective if the code and architecture of the internet are regulated correctly. Murray goes above that and identifies that the regulators can design a model regulation, in order to regulate e-commerce taxation as the main basis in the regulators design system, which signifies the importance of such regulatory design.³⁹ Also Benkler, another cyber-regulatory theorist, adopts the same idea of introducing regulation into the network through the logical infrastructure or the code layer⁴⁰, which is an idea tax authorities can make use of and try to adopt tax systems based on the internet’s infrastructure. There has also been significant

³⁸ Lessig, (2002) Code and Other Laws of Cyberspace, (now Code v2, 2007) , Also revisited the idea in Free Culture, 2004)

³⁹ Murray (2007) The regulation of cyberspace, Routledge-Cavendish, Ch 2

⁴⁰ Benkler (2000), From Consumers to Users; Shifting the deeper structures of regulation toward sustainable commons and user access

contribution in this field by the other major actor the US. One of the US theorists is McLure,⁴¹ who mainly argues in favour of taxation and also for the implementation of a federal tax regime, using VAT as an example of efficiency. Pastukhov also brings in the discussion of implementing all the relevant factors in the discussion; mentioning aspects of technology, law, economics and fiscal elements, in an attempt to try and identify an all-rounded solution.⁴²

Another issue to be examined is the electronic commerce literature. From Paul Todd⁴³ and Reed to Hedley⁴⁴ and other authors, the literature is renewed constantly because of the ever-changing nature of cyberspace and the continuous development of trends and useful applications on internet. Electronic commerce is a new phenomenon, and the law has to attempt to apply control on it as efficiently as possible. Some of the authors are more open to suggestions and radical attempts to regulation. One of these authors, Todd, makes a valid reference to US and Singapore data, as they are two jurisdictions with developed, or significantly developing, systems in place. He is using it as an opportunity to take out significant information for future in the UK or the EU context.

⁴¹ McLure (1997) Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws , 52 Tax L. Rev. 269 ; McLure (2003) The Value Added Tax on Electronic Commerce in the European Union, International Tax and Public Finance, , Volume 10, Issue 6, pp 753-762

⁴² Pastukhov, O, (2010) "Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on the International Taxation of Electronic commerce", 36 Rutgers Computer & Tech. L.J. 1, Available at http://heinonline.org/HOL/Page?handle=hein.journals/rutcomt36&div=4&g_sent=1&collection=journals

⁴³ Todd, (2005) Electronic commerce Law, Cavendish

⁴⁴ Also IT & electronic commerce / edited by Steve Hedley, Tanya Aplin.2004

Not all include extensive chapter for taxation and online activities, however, Chissick's chapter 11, is specifically on Taxation of electronic commerce⁴⁵ discussing the parameters around the topic, the main issues and the current legislation.

5. Methodology

As previously mentioned this thesis will examine the challenges presented due to the nature of internet, when consumption taxes are to be applied to electronic commerce transactions. Also, it will attempt to consider the harmonisation as a demanding but perhaps fitting approach. There will be discussion of the current regulatory approaches; and their origins where necessary to comprehend the development. Different perspectives will be considered mainly by a comparative analysis of EU and US approaches of VAT and Retail Sales Tax respectively. One limitation to be identified to the author is the lack of previous tax and accounting knowledge in order to incorporate tax models and practical case studies for a practical addressing of the issue in question. The methodology to be used throughout my research project is mainly going to be literature review and analysis of the published works, either in the form of a book, journal articles, reviews, and reports by the EU or institutions such as OECD, DTI or WTO as well as online blogs and magazines, such as The Economist.

⁴⁵ Chissick (2000) Electronic Commerce Law and Practice, Sweet & Maxwell

6. So what are the main issues?

International tax issues in the area of electronic commerce are various and include the nexus of the vendor and tax enforcement. Some of these challenges may identify more to direct than indirect taxation, but it is still significant to view the wider area before focusing in at the ones relating to indirect taxation. Taxing authorities may have great difficulty collecting revenue from vendors conducting commerce via foreign internet addresses. A vendor could relocate operations to a foreign country to obtain favourable tax treatment, or may locate its internet site at a foreign address to give the impression that its actual business location is in a foreign country. The lack of an identifiable physical location is a significant problem in the process of taxing electronic commerce.⁴⁶

In cases of cross-border electronic commerce transactions, the tax issues become even more problematic because, according to the principles of international taxation, when a resident of one country earns income from economic activity in another country, both countries have a right to tax the same income: the home state based on residence rule,

⁴⁶ R. Bruce Josten, “ Issues in Search of Answers: Electronic commerce Taxation” submission to the Advisory Commission on Electronic Commerce, September 8, 1999

and the host state based on the source rule of taxation⁴⁷. There are some areas which also need clarifying; one is the characterization of the income generated by the electronic commerce transaction: is it royalty, business profit, or something else. Another area is to determine what constitutes a permanent establishment (PE) in the source country and attribution of income to the PE.

In the tax treaties based on the OECD Model Tax Convention,⁴⁸ an enterprise providing services abroad is taxable in that country where it conducts business only if it has a PE there. According to Art.5 para.1 of OECD MC, a PE presupposes the “fixed place of business”, which may include premises, facilities or installations. A permanent establishment is generally defined as a fixed place of business, an office, a branch, a factory or a similar setting. This definition excludes mobile places of business. Paragraph 2 of the Commentary to Art.5 (I) of the 1992 Model Treaty lists three components to the definition of a PE: 1. the existence of a place of business, i.e. a facility such as premises or, in certain instances, machinery or equipment; 2. this place of business must be “fixed”, i.e. it must be established at a distinct place with a certain degree of permanence; and 3. the carrying on of the business of the enterprise through this fixed

⁴⁷ Paul R. McDaniel, Hugh J. Ault, James R. Repetti (2005) Introduction to US International Taxation, Aspen Student Treatise Series

⁴⁸ OECD Model Tax Convention. See “ The Application of the Permanent Establishment Definitions in the Context of Electronic Commerce: Proposed clarification of the Commentary on Article 5 of The OECD Model Tax Convention” , Revised Draft for Comments, March 3, 2000, at <http://www.oecd.org>.

place of business. This means usually that persons who, in one way or other, are dependent on the enterprise (i.e. its personnel) conduct the business of the enterprise in the state in which the fixed place is situated.⁴⁹ Electronic commerce may erode the requirement for physical presence further, as “intelligent” software develops.⁵⁰ More specifically for indirect taxation the principle of origin and destination is also examined by Basu, as well as looking at the digitization or not of goods and services, which is rather uncertain when considering the nature of cyberspace⁵¹. According to Basu, intangibility of products does pose a significant workload on tax authorities as it makes it problematic to identify the details of origin and destination.⁵²

Taxation acts as a tool of good governance, allowing economies to grow while helping to improve society as a whole⁵³. Electronic commerce and globalization are challenging to traditional tax regimes. Historically goods were physical, the production, distribution and consumption of these goods was easily taxable. Physical goods were produced at a manufacturing plant, shipped off to wholesalers and boxed on retailers’ shelves, with the final consumer walking away with a paid for (and taxed) product. Tax collection was

⁴⁹ Calvert, Walter R (2000), ‘Taxation of Internet Commerce’. <http://www.venable.com> (path: internet/tax.html#international) .

⁵⁰ C. Brodersen, (1997)“ Taxation of Cross-border Electronic Commerce: Germany” 25(4) *Inter Tax International Tax Review* 133.

⁵¹ Basu S, (2002) 'European VAT on Digital Sales', The Journal of Information, Law and Technology (JILT) (3) Available at: http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_3/basu/

⁵² Basu.(2003) "Relevance of Electronic commerce for Taxation: an Overview" *Global Jurist* 3.3 .

⁵³ Gelleny, Ronald D., and Matthew McCoy.(2001) "Globalization and government policy independence: The issue of taxation." *Political Research Quarterly* 54.3 509-529.

in the hands of the retailers. The retailer charges the consumer VAT, or sales tax, and then remits this to the government. Some academics, such as L. I. Krever argue there is nothing new really with electronic commerce and taxation, arguing it's simply "old wine in new bottles". It is generally accepted that tax rules for sale of intangible products and services should be the same, as those of other goods, that the means of delivery should not govern tax treatment. But one should consider that intangible products include products such as music, software and services such as medical or legal consultations⁵⁴, which are "produced" at one location and "consumed" somewhere else, are so different in nature. Such "technologically neutral"⁵⁵ taxation would not treat the sale of a paperback book any differently than the sale of a digitized book. On the other hand, determining which products are functionally equivalent is a problematic proposition. If digitized products are treated as services, then further guidance is needed to specify which source of supply rules for services shall govern because there are many different rules for different types of services.⁵⁶

The proper metaphor for electronic commerce activities of Internet-only merchants is that of colonialism exploiting local markets by taking resources out of the community

⁵⁴ Lukas, Aaron. (2012) "Tax Bytes: A Primer on the Taxation of Electronic Commerce." Available at <http://www.cato.org/publications/trade-policy-analysis/tax-bytes-primer-taxation-electronic-commerce?print>

⁵⁵ OECD Electronic commerce : taxation framework conditions, 1998, available at <http://www.oecd.org/tax/consumption/1923256.pdf>

⁵⁶ Nehaluddin Ahmad (2008) The tax net and the challenges posed by electronic commerce: a critical examination, Computer and Telecommunications Law Review

without returning anything in kind.⁵⁷ Taxing online sale of intangible is problematic because the location of customers cannot be known with certainty. Many online shoppers do not feel comfortable giving unnecessary personal information to a web site. Consequently, they may refuse to type it in, shop at a site that does not require it, or simply lie⁵⁸. This will probably lead to multiple taxation or non-taxation. Hence, differentiated Internet taxation rules among countries could have a significant impact on consumers' purchasing behaviour, shifting from domestic to foreign suppliers⁵⁹. This raises several problems for tax authorities. First, it leads to the gradual elimination of intermediaries, such as wholesalers or local retailers, who in the past have been critical for identifying taxpayers, especially private consumers. Second, foreign suppliers may be tax-exempted, whereas local suppliers are normally required to charge value added tax (VAT) or sales taxes. Third, direct orders from foreign suppliers could substantially increase the number of low-value shipments of physical goods to individual customers. These low-value packages now fall under so-called *de minimis* relief from customs duties and taxes in many countries⁶⁰, basically to balance the cost of collection and the amount of tax due. A substantial increase in these shipments as a result of e-commerce (where foreign suppliers replace domestic ones) could pose an additional challenge to tax as well as customs authorities.

⁵⁷ Warren, NA, (1998), 'Taxation of internet trade', Asia Pacific tax bulletin, pp. 412 - 420

⁵⁸ RIFAT AZAM (2007) Electronic commerce Taxation and Cyberspace Law: The Integrative Adaptation Model, , Virginia Journal of Law & Technology Association, VOL. 12, NO. 5

⁵⁹ Vakul Sharma, (2011) Information Technology Law and Practice, Universal Law Publishing, 3rd ed

⁶⁰ Lymer & Hasseldine, (2005) The international Taxation System, Kluwer

The challenges to EU tax authorities that arise from e-commerce therefore lie in non-EU supplies of e-services to EU customers (and in an increase in non-EU customers not subject to EU VAT). Under current legislation they are not exempted from VAT, thus stopping what previously was a problem by having their share increasing, in direct competition with EU suppliers who were subject to VAT payments. Furthermore, the VAT exemption provides incentives for suppliers to locate outside the EU, a fairly easy undertaking in e-commerce, which no longer requires the presence of human and technical resources. On the other hand, if rules are not harmonized internationally, the risk of double taxation may keep foreign suppliers/competition out; and non-taxation may distort competition against local suppliers.⁶¹

It seems reasonable to move VAT collection to the place of consumption, away from the location of the seller, following the OECD guidelines. Here, a key problem for tax authorities will be to identify the customer and the location of the jurisdiction responsible for collecting the tax⁶². As a result of the process of disintermediation, apart from the seller and the customer there are no other parties involved in the transactions (which could collect the tax). Credit card companies, Internet service providers (ISPs),

⁶¹ European Commission, Proposal for a council directive amending Dir. 77/388/EEC, 2000

⁶² Daniel Ho, Brossa Wong, Alex Lau, (2008) E-business in a globalising world: Hong Kong legal and tax perspectives, Company Lawyer, 29(3),

banking and payment systems providers or telecommunications companies have been mentioned as potential new intermediaries in verifying the location of a customer and the respective tax jurisdiction.⁶³

6.1 Current initiatives

What are the current systems in place? Two main ones, due to the size of their systems, are EU and USA. EU has the VAT and US has the sales tax; that signifies one major difference already! In EU the VAT and Electronic commerce Directive came into force on July 1, 2003⁶⁴. The Directive introduced a major change to the rules governing the place of supply of electronically supplied services. The place of supply of such services where supplied to non-taxable persons is shifted to where the customer consumes the service whereas previously such services were treated as supplied where the supplier was established. The result of this change is that supplies of electronic services over the internet made by suppliers established outside of the EU are brought within the remit of European VAT, a change of enormous economic and administrative significance to non-EU software suppliers, content providers and other suppliers of games, music and video in digital form.

⁶³ William Craig, (2001) Taxation of electronic commerce, Butterworths Tolley Ltd.

⁶⁴ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52003DC0702>

The Directive also represents something of a landmark in fiscal policy worldwide as the EU attempts to put into effect its tax laws way beyond its physical boundaries, rather like the State of California's mistaken assertion of worldwide taxing rights⁶⁵ but on a grander scale. Surprisingly, the EU did so without fully considering the implications of such an assertion of taxing competence or did so trying to be arrogant and disregarding the consequences.

J Irvinson, like many of US-based academics, argues that because the ground rules have changed so fundamentally, it must only be a matter of time before EU suppliers find that their exports to non-EU consumers drag them in to the tax net of a variety of different jurisdictions, creating such administrative complexity that the industry will either substantially operate outside of the law or collapse under the weight of administrative bureaucracy and double taxation.⁶⁶ This criticism was rather serious from the US and it was possibly a regulatory move by the EU which could have had detrimental consequences.

⁶⁵ FTB Publication 1031 Guidelines for Determining Resident Status — 2011.
https://www.ftb.ca.gov/forms/2011/11_1031.pdf

⁶⁶ Jonathan Irvinson, (2004) Overstepping the boundary - how the EU got it wrong on electronic commerce, , Computer and Telecommunications Law Review, (10-4)

Non-EU businesses supplying electronic services now must register for VAT, determine the location and tax status of each of their customers, collect the appropriate rate of VAT, dependent on the Member State they are registered in, from the customer and remit it together with the VAT return. A special scheme allows them to register in only one EU Member State who will effectively operate a system to ensure that each Member State receives the appropriate amount of VAT due to them. In the absence of such a scheme it would have been a logistical chaos with businesses making relevant supplies in all 25 Member States would be required to file 25 returns; 25+ tax systems they would need to be aware of! The Vat MOSS (Mini One Stop Shop) is a very beneficial tool and a practical factor in the VAT procedure; it will be discussed more in detail in the EU chapter.

Council Directive 2002/38/EC on the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services was adopted on 7 May 2002 and entered into effect on 1 July 2003. Council Directive 2008/8/EC adopted on 12 February 2008, these VAT arrangements were extended until 31 December 2009. As far as electronically supplied services are concerned, these measures are explained below.⁶⁷

⁶⁷ http://ec.europa.eu/taxation_customs/taxation/vat/consumers/electronic_commerce/index_en.htm

Council Regulation (EC) 792/2002, temporarily amending Regulation (EEC) 218/92 on administrative co-operation in the field of indirect taxation (VAT) subsequently included in Regulation (EC) 1798/2003, introduces additional measures necessary for the registering for VAT purposes of e-service traders not established within the Community and for distributing the VAT receipts to the Member States where the services were actually used.⁶⁸ Under these rules, EU suppliers are no longer obliged to charge VAT when selling on markets outside the EU, thereby removing what previously was deemed a disadvantage; EU suppliers had to charge VAT when supplying digital products even in countries outside the EU. Now the obligation is on non-EU suppliers to charge VAT as EU suppliers when they are providing electronic services to EU non-taxable persons, something which EU businesses had been actively seeking for some time... It follows from Directive 2008/8/EC that the rules introduced by the Directive 2002/38/EC will be extended from 1st January 2010 as a permanent measure. From 1st January 2015, this Directive also provides that VAT on telecommunications, radio and television broadcasting and electronic services supplied by a supplier established within the

⁶⁸ Hardestey, David (2000), 'Europe Proposes New Taxes on Non-EU Sellers', 18th June 2000, Electronic commerce Tax News

Community to non-taxable persons also established within the Community will be charged in the Member State where the customer belongs.⁶⁹

The EU attempted to construct a basic framework for the future regulation of electronic commerce.⁷⁰ This, along with other official initiatives and reports, gives insight into the basic philosophy followed by the EU in the regulation of electronic commerce.⁷¹ The US on the other hand is attempting to keep things less regulated while criticizing the EU's attempt⁷²; there are still taxes for electronic commerce are very limited and there is a prohibition of new ones to be made, or to multiply older ones. In 1998, the Internet Tax Freedom Act was enacted to help economic growth by preventing fledgling e-businesses from being burdened with new taxes and tax compliance, and to create a moratorium on new taxes⁷³. While the US is attempting to focus on a more international view of the marketplace in terms of developing the market for an internet age, the EU approach seems to be more confined on building up the internal marketplace and protect the

⁶⁹ http://ec.europa.eu/taxation_customs/taxation/vat/consumers/electronic_commerce/index_en.htm

⁷⁰ Council Directive 2000/31, 2000 O.J. (L 178) 1

⁷¹ Accelerating Electronic commerce: EU Actions, at http://europa.eu.int/information_society/eeurope/action_plan/stimulatelecommerceeu/targets_2000/index_en.htm. See also Communication From the Commission to the Council and the European Parliament: Electronic commerce and Financial Services, COM(2001) final at 2, at http://europa.eu.int/comm/internal_market/en/finances/general/ecom_en.pdf ; A European Initiative in Electronic Commerce: Communication to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, COM(97)157 at 4, at <http://www.cordis.lu/esprit/src/ecomcom.htm>

⁷² European Union reached across borders- EU proposes to tax US-based electronic commerce companies with VAT in the EU, Snel Jan, 2000

⁷³ Internet Tax Freedom Act, Pub. L. 108-435 [S. 150] (Dec. 3, 2004).

member states interests as well as the rights of consumers. EU is attempting to create more cohesion to the EU-wide market; internet access is illustrated as a paramount for consumers in EU member states, adopting common policies in regard to access and development plans.⁷⁴

The fact that internet is borderless makes it even easier for EU to regulate, or attempt to regulate by means of the aforementioned Directives, for the market as a whole since many physical barriers are not there. On the other hand that is not the case with many of the States in the US; they are joined in a federalist system but there are many regulatory frameworks separating them than actually keeping them joined in a matter such as taxation of the internet.⁷⁵ Some of the states have different regulations even under the Internet Tax Freedom Act⁷⁶; some exempt from sales tax certain types of downloads or they even go as far as have no sales tax for downloading services or goods.⁷⁷ Regulation in the EU should thus be kept to a minimum, not to overburden, and

⁷⁴ Subhajit Basu, (2007) Global Perspectives on Electronic commerce Taxation Law,

⁷⁵ Jinyan Li, (2003) International Taxation in the Age of Electronic Commerce: A Comparative Study (Toronto: Canadian Tax Foundation,), 509

⁷⁶ Yang,,Chang and Xing, (2005) Current Status of Internet Commerce Taxation, Yang, , Journal of State Taxation, , available at

http://heinonline.org/HOL/Page?handle=hein.journals/jrnsttax23&div=27&g_sent=1&collection=journals

⁷⁷ K. Charles (2005) Taxing the Internet-The state's next frontier, , Journal of State Taxation

has to be clear and consistent, so as to keep the EU member states unified to the same aim.⁷⁸

The EU system, and the US as was briefly mentioned, is the two main systems, both because they are jurisdictions with a great number of different member states, thus meaning great number of consumers and online trade flourishes. EU as a pioneer in VAT regulation⁷⁹ seems now to be “comfortably arrogant” in its regulation, even if it causes controversies, as Ivinson argued⁸⁰. US on the other hand, takes a more “safe” approach and not challenging perceptions yet.⁸¹ However the consensus is that only a common approach will ensure the issues created by cyberspace will be tackled efficiently⁸².

Although there are always critics of the international cooperation idea, such as Tanzi, who doesn't completely disregard it, but he is seems fairly confident it's close to a

⁷⁸ Basu, (2007) Global Perspectives on Electronic commerce Taxation Law, Ashgate

⁷⁹ Hardestey, David (2000), 'Europe Proposes New Taxes on Non-EU Sellers', 18th June 2000, Electronic commerce Tax News

⁸⁰ Ivinson, Jonathan (2003) Why the EU VAT and Electronic commerce Directive Does not Work International Tax Review International Tax Review, 2003

⁸¹ Ward, B. and Sipior, J, (2004) To Tax or Not to Tax Electronic commerce: A United States perspective, Journal of Electronic Commerce Research, VOL. 5, NO.3, Available at <http://www.csulb.edu/web/journals/jecr/issues/20043/Paper3.pdf>

⁸² Rohlfing, Ingo. and Rixen, Thomas. (2004) "Bilateralism and Multilateralism: Institutional Choice in International Cooperation. The Examples of International Trade and Taxation" Paper presented at the annual meeting of the American Political Science Association, Hilton Chicago and the Palmer House Hilton, Chicago, IL, Sep 02, Available at http://www.allacademic.com/meta/p59928_index.html

utopia⁸³. Craig disagrees with Tanzi, by arguing that regulation is possible and it should be made possible through cooperation of EU and US, and then to a more international context.⁸⁴ There are still some authors that consider a more “romantic” approach by thinking whether to liberate electronic commerce completely in order to promote global trade, which subsequently would mean that taxation would not even be an issue as well. Hellerstein produces a somewhat different perspective, basically arguing not the liberalization but how best to utilize electronic commerce to promote trade⁸⁵.

The cooperation concept is challenging, if one considers the amount of criticism EU received after the imposing new taxes on non-EU sellers.⁸⁶ Tax systems have been inexistence since rather old times⁸⁷ and these systems have always presented people with perplexed situations⁸⁸. The attempts by EU do provide a glimpse of hope that international cooperation may indeed occur, and it seems the first steps have been made already by regulation directly affecting non-EU vendors; regulation which even

⁸³ Tanzi, Is there a need for a World Tax Organisation, pp. 173-186,1999, In The Economics of Globalization Policy Perspectives from Public Economics by Razin & Sadka

⁸⁴ William Craig, Taxation of electronic commerce, Published by Butterworths Tolley Ltd. , 2001

⁸⁵ W Hellerstein ,Electronic commerce and the challenge for tax administration. UN, 2001., 2002

⁸⁶ Europe Approves Net Tax Law, Reuters (2002) , <http://www.wired.com/news/print/0,1294,52351,00.html> ,/ US not happy about EU Tax, J. Glasner, 2002, <http://www.wired.com/news/print/0,1294,52378,00.html>

⁸⁷ Davies: principles of tax law. Sweet & Maxwell; 6th ed 2004

⁸⁸ Musgrave, Peggy B. "Combining Fiscal Sovereignty and Coordination." THE NEW PUBLIC FINANCE (2006): 167.

though criticized has received positive feedback and has not created an obstacle in the development of e-commerce⁸⁹.

The main question then remains; Electronic commerce should be taxed, but which is the most efficient manner to do so? The answer should take into consideration certain factors to appreciate the different “unique” character of the online environment, and the manner in which the authorities can regulate as well as the relationship of the “actors” in the area to the regulation.

7. Structure

Chapter 2

The second chapter will examine the challenges presented to taxation authorities and governments due to the development of Internet and Electronic commerce. There will be discussion of geographical boundaries and lack of due to cyberspace, bringing jurisdictional matters into the analysis. The discussion will look into the changes brought by the Internet and the potential to impose on online sales, compared to conventional

⁸⁹ Jonathan Ivinson, (2004) Overstepping the boundary - how the EU got it wrong on electronic commerce, , Computer and Telecommunications Law Review, (10-4)

sales, as well as elements of lack of documentation, Permanent Establishment. The second chapter is introducing the discussion of should electronic commerce be subject to tax and the different views on this question.

Chapter 3

Chapter 3 is examining the tax elements relevant and the challenges specific to different type of taxes. It then analyses the importance of the Adam Smith's 4 Canons, Equity, Certainty, Convenience and Efficiency, to contemporary discussion on how efficiency can be assessed for electronic commerce reasons.

Chapter 4

Chapter 4 is the one studying the Soft Law, predominantly by OECD and WTO, and also looks at the development, or lack of, in the US. The Ottawa principles for electronic commerce are examined individually and also the initiatives from WTO are brought into the discussion. Then the US jurisdiction and approaches is analysed, from the plethora of different tax regimes to the current Internet Tax Freedom Act, holding a tax "freeze" on any new taxes for electronic commerce and the Internet. Finally the Streamlined

Sales tax Project is considered, and the Marketplace Fairness Act as perhaps steps bringing the two major jurisdictions, EU and US, closer to cooperation with a view to harmonisation.

Chapter 5

Chapter 5 is bringing the EU into the discussion of consumption taxes and the implications for electronic commerce. From the initial approaches taken by EEC for harmonisation of the European Economic Community and subsequently the European Union, to the VAT Directives and the current initiatives. Also, the efficiency of the EU policies will be examined in order to assess whether there is a need for major alterations for the future or the opportunity is already there with the current legislation.

Chapter 6

The sixth chapter is looking into the VAT and Sales Tax comparison, with the VAT characteristics considered closely to identify its merits as a tax. First, VAT and RST are put side by side to look into their compatibility and whether they are significantly opposite forces. Some academic and jurisdictional methodologies relating to e-

commerce taxation are brought into the analysis as well to evaluate the characteristics necessary for an efficient consumption tax for e-commerce.

Chapter 7

The last chapter is the one where the two main approaches by EU and the US are analysed with the perspective to illustrate the one with more merits and advantages. Moving on, Harmonisation is analysed as a notion and also looking at the reasons why it should provide a good way forward, as well as presenting the opposing arguments on why it may still be an unrealistic proposal. The last arguments by the thesis are concentrating on harmonisation as a potential way forward, but also recognising that potentially it could merely be the reality of closer cooperation first before harmonisation materialises.

2. Electronic commerce and challenges to taxation

Contents

2. Electronic commerce and challenges to taxation.....	50
1. Introduction	54
2. What is electronic commerce?	59
3. Should electronic commerce be taxed?.....	65
3.1 One set of rules or “real” & “virtual” rules separately?	69
3.2 Cyber-libertarianism	71
3.3 Neutrality	73
4. Challenges electronic commerce poses for taxation	74
4.1 Jurisdictional matters.....	75
4.2 Anonymity.....	78
4.3 Determining Place of Supply; the importance of Permanent Establishment	80
4.4 Digitization; Goods or services?	81
4.5 Dominance by a few players	82
5. Specific challenges electronic commerce presents to VAT.....	85
5.1 To Income Tax	86
5.2 To VAT	88
6. Conclusion	97

This Chapter examines the way that taxation is affected by electronic commerce. It allows an introduction to the main challenges presented to taxing e-commerce transactions, which will be further approached in the following chapters. Also it provides a clarification on the central matters, which are setting the basis for the subsequent discussion. It provides an overview of the broader questions of why it can be problematic to tax electronic commerce, what are the main challenges, considering the tax authorities as well as the consumer and the businesses involved, taking into consideration the international perspective this topic entails. Electronic commerce presents a radical transformation of the nature of commercial activities; this creates significant challenges to regulations and elements of tax systems that are not specifically directed towards the “virtual” commercial world. The task of taxing electronic commerce can be challenging to conventional taxation regimes and potentially posing obstacles, for instance allowing for difficulty in enforcement of regulation, non-compliance and loss of revenue for the State. The chapter will show the problems which may appear as consequence in the case of non-applicability; double-taxation, electronic fraud, jurisdictional issues, all complicating online commercial transactions. Ultimately these may prevent the internet growing to its full potential as a new virtual commercial world, even replacing the traditional way of conducting business. However, the challenges posed by electronic commerce to taxation, especially due to the global

nature of Internet and its operations, also presents opportunities on a commercial, legal and technological stage. After Ottawa, where OECD examined the issue of electronic commerce⁹⁰ and taxation, taxing online commercial activity is becoming an e-business reality. As a result the objective should be the realization of a formula of worldwide harmonized e-commercial regulations to achieve economic, legal and social efficiency. Thus, this chapter will assist to draw upon some conclusions on the main challenges as well as setting the perspective for the discussion of the main themes in the rest of the thesis.

⁹⁰ Taxation and Electronic Commerce Implementing the Ottawa Taxation Framework Conditions, 2001, <http://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf>

1. Introduction

The internet has presented the market with a dramatic change in commercial practice. In a remarkably short period of time electronic commerce developed from a technological novelty to a permanent feature of the transformation of commercial activities⁹¹. This introduction starts from a general aspect and the chapter will be going into more specific elements relevant to the thesis. A major shift in the commercial

⁹¹ Singh, Nitish, Hadi S. Alhorr, and Boris P. Bartikowski. (2010) "Global electronic commerce: A portal bridging the world markets." *Journal of Electronic Commerce Research* 11.1 : 1-5. Also, Nuray Terzi,(2011) The impact of electronic commerce on international trade and employment, *Procedia - Social and Behavioural Sciences*, Volume 24,, Pages 745-753, ISSN 1877-0428, 10.1016/j.sbspro.2011.09.010. (<http://www.sciencedirect.com/science/article/pii/S1877042811015382>)

practices around the globe can result in regulations and regulatory regimes facing compliance issues.⁹²

This chapter is going to present the main themes of the thesis, by identifying the main challenges of assessing the taxing of electronic commerce activities. It will discuss the challenges facing governments and regulatory bodies, such as the OECD and WTO, regarding traditional tax concepts and their adjustment for an e-business environment. The chapter will show the potential problems which could appear as a result of lack of regulatory uniformity and lack of total clarification on the related jurisdictional matters, since electronic commerce allows the potential of more than one state to be involved in a transaction. Other issues that raise concern can be identified as electronic tax fraud and anonymity. The advent of electronic commerce, especially after Ottawa⁹³, where the OECD initially examined the issue of electronic commerce and taxation, changed many aspects of how business is done and also brought inevitable need for adapting to that change. The ideal objective could be a regulatory framework allowing the creation

⁹² McLure, Charles E. Jr (1997) Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws 52 Tax L. Rev. 269

⁹³ OECD Ministerial Conference, "A Borderless World: Realising the Potential of Electronic Commerce" on 8 October 1998

of the basis for worldwide homogenised e-commercial regulations to achieve economic, legal and social efficiency. That step still seems far away from being practical though.⁹⁴

Electronic commerce presents a key economic activity driving growth for developed as well as developing countries.⁹⁵ Internet use has witnessed significant growth and online purchases globally combined with the relatively low cost internet marketing have enabled to expand their market.⁹⁶ The Internet and other techniques of distance communication have made it possible for both large multinational enterprises and small and medium sized companies to reach business partners and potential customers all over the world⁹⁷. Electronic commerce can be categorised as such: business-to- business (B2B), business-to- consumer (B2C), government-to-consumer (G2C), government-to- business (G2B), and the more recently developed is consumer-to-consumer (C2C) electronic commerce activity. These categories represent types of transaction affecting most people. For instance, G2C and G2B, or e-government, focuses on delivering citizen-

⁹⁴ Paris, Roland. (2003) "The globalization of taxation? Electronic commerce and the transformation of the state." *International Studies Quarterly* 47.2 : 153-182. Also, Roxan, Ian. (2010) "Limits to Globalization—Some Implications for Taxation, Tax Policy and the Developing World." .

⁹⁵ OECD Background Report on Empowering e-consumers, Washington 2009, <http://www.oecd.org/dataoecd/44/13/44047583.pdf>

⁹⁶ OECD (2008), "Shaping Policies for the Future of the Internet Economy", *OECD Digital Economy Papers*, No. 148, OECD Publishing. <http://www.oecd-ilibrary.org/docserver/download/fulltext/5kz83bgb888s.pdf?expires=1336471952&id=id&accname=guest&checksum=BF638A5ABEB9460F78C96FDC8C39AA83>

⁹⁷ Kamlesh T. Mehta & Vivek Shah, (2001) Electronic commerce: The Next Global Frontier For Small Businesses, *The Journal for Applied Business Research*, Vol 17, No 1 (also see Roose, Eric N, (1998) "Global Taxation of Electronic Commerce", 4 *Asia-Pacific Tax Bulletin* 7, pp. 248-259.)

centric services via the Internet by providing the framework for local citizens to file income tax returns, renew car taxation disks, submit requests to local authorities re certain documentation, and access and comment on proposed regulations that could affect their lives⁹⁸. Today, a user of a device able to connect to the internet can purchase a wide variety of things such as music, clothing, books, jewellery, and software. It is possible to purchase insurance, and buy groceries over the Internet. Banking transactions can be accomplished quickly and efficiently online.

Information technology advancements have been challenging many traditional concepts and approaches, such as the idea of boundaries and strict jurisdictional controls. More specifically world economies have been faced with a problematic, or rather challenging, scenario because of the development of electronic commerce (electronic commerce). That situation has proven difficult for tax policymakers⁹⁹. The growth of electronic commerce has altered the way business is conducted; shifted the basis from a physically-orientated commercial environment to an information-based environment¹⁰⁰. This growth and proliferation of Internet and more specifically of electronic commerce

⁹⁸ Office of Technology and Electronic Commerce (US Dept. of Commerce International Administration) 2009, [http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/\\$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%202016.pdf](http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%202016.pdf)

⁹⁹ Ivinson J, (2004) "Overstepping the Boundary – How the EU got it wrong on Electronic commerce", Computer and Telecommunications Law Review, 2004, 10(1),(1-4)

¹⁰⁰ Subhajit Basu (2003) "Relevance of Electronic commerce for Taxation: an Overview", Global Jurist Topics: Vol.3: No. 3, Article 2. <http://www.bepress.com/gj/topics/vol3/iss3/art2>

has affected many of the policymakers, such as the EU to state that their aim is “...to encourage the vigorous growth of electronic commerce [in Europe]”¹⁰¹. Since it first appeared in mid-1990’s, the online commercial activity has been constantly expanding¹⁰².

Electronic commerce entails new characteristics that can challenge theories and well-grounded rules of existing tax systems, for example the Permanent Establishment concept of being able to locate all transactions in physical space¹⁰³. Also, location of supply is another principle which is very important to consumption taxation but e-commerce has challenged it; the OECD places more importance upon place of consumption. The purpose of this chapter is to present the main issues arising from the relationship of electronic commerce and tax, as well as examine these issues from the perspective of certain bodies, policy makers and commercial ones. Before examining the difficulties electronic commerce presents for tax authorities, it is important to assess the nature of electronic commerce and its significance for present and future economic activities.

¹⁰¹ European Commission (1997, 15th April), “A European Initiative in Electronic Commerce (Green Paper)”, COM(97) 157

¹⁰² OECD, Implementation of the Ottawa Taxation Framework Conditions – The 2003 Report, OECD 2003

¹⁰³ Ronald Paris,(2003) “The globalisation of Taxation? Electronic Commerce and the transformation of the State” International Studies Quarterly, 2003 47, 154

2. What is electronic commerce?

E-commerce is the main aspect of the thesis so a definition would be would be beneficial in order to identify the nature of it and appreciate that when looking at its taxation. Sales transactions taking place over the Internet or via computer is a very simplistic definition. Conducting a simple search on Google.com by the search keywords “definition AND electronic commerce” responded with 5,770,000 results from a variety of sources from public, commercial and educational websites. Although there appears to be some consensus to what the definition should be, there is not one universally accepted definition. Different institutions and bodies will use the term to describe similar but slightly different things, as is illustrated by the following discussion; some different definitions and approaches to what electronic commerce is perceived to be, from industry agents, to research institutions and governmental bodies.

A few examples are "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet access."¹⁰⁴ , “any transaction completed over a computer-mediated network that

¹⁰⁴ Internet Tax Freedom Act, Pub. L. No. 105-277, § 1104(3), 112 Stat. 2681 (1998).

involves the transfer of ownership or rights to use goods or services”¹⁰⁵ , and “Commerce that is transacted electronically, as over the Internet”¹⁰⁶. The US Department of Commerce sees electronic commerce as the online transaction of business, featuring linked computer systems of the vendor, host, and buyer. Electronic transactions involve the transfer of ownership or rights to use a good or service. In 2006 recently, Turban et al. have defined electronic commerce from the managerial business perspective as “the process of buying, selling, transferring, or exchanging products, services, and/or information via networks, including the Internet”¹⁰⁷ . According to McKay & Marshall (2004)¹⁰⁸, e-business is the use of the Internet and other information technologies to support commerce and improve business performance. This definition is extending the reach to cover the digitalization of business process taking place during the transaction but, however, it is still from the businesses’ perspective rather than the consumers’.

According to Davies LJ “Electronic Commerce could be said to comprise commercial transactions, whether between private individuals or commercial entities, which take place in or over electronic networks. The matters dealt with in the transactions could be intangibles, data products or tangible goods. The only important factor is that the

¹⁰⁵ <http://www.census.gov/epcd/www/ebusines.htm>

¹⁰⁶ <http://www.thefreedictionary.com/Electronic+commerce>

¹⁰⁷ Turban et al, (2004) Electronic Commerce and Update Package, Prentice-Hall,

¹⁰⁸ McKay, J. and Marshall, P. (2004) Strategic Management of e-Business. John Wiley & Sons, Brisbane

communication transactions take place over an electronic medium”¹⁰⁹ . The Organisation for Economic Co-Operation and Development (OECD) back in 1999 indicated a respectable development of electronic commerce; they expected that electronic commerce would reach a value of \$330 billion in 2001 and would raise up to £1 trillion by 2003-5.

It is evident from the variety of definition relating to electronic commerce that it is not easy to encapsulate completely every element of its nature; OECD and the WTO have been adjusting their definitions in an attempt to be as adequate and accurate as possible. OECD in 1997 provided a brief definition for electronic commerce as “...all forms of transaction relating to commercial activities, including both organisation and individuals, that are based upon the processing and transmission of digitised data, including text, sound and visual images...”¹¹⁰ while a year later the WTO referred to “..The production, distribution, marketing and sale or delivery or delivery of goods and services by electronic means” and in 1988 they refer to the infrastructure by talking about “..The provision of Internet access services & the electronic delivery of services & distribution over the Internet...”¹¹¹

¹⁰⁹ Davies LJ (1998) “A Model for Internet Regulation”, <http://www.scl.org>

¹¹⁰ <http://stats.oecd.org/glossary/detail.asp?ID=4721>

¹¹¹ WTO, Committee on Trade, and Development, November 1998

Some of the definitions so far, have not been academic, as they are provided from industry representatives, identifying the perspective perhaps of the vendor rather than the consumer. A Report of the Electronic Expert Group to the Attorney General (Australia)¹¹² presents another definition for electronic commerce, which appears to be more inclusive and emphasizes it as a transaction carried out by electronic means. It reads *“Electronic commerce is a broad concept that covers any commercial transaction that is effected via electronic means and would include such means as facsimile, telex, EDI, Internet and telephone. For the purposes of this report the term is limited to those trade and commercial transactions involving computer-to-computer communications whether utilising an open or closed network”*¹¹³. Another definition in Basu’s book, this time by Davies provides a definition which suggests that the “only important factor is that communication transactions take place over an electronic medium^{114”}.

As it was illustrated so far, definitions for electronic commerce seem to be ranging from broad and extensive to rather concise and simple formulations. In a paper introducing electronic commerce, European Union has attempted to describe the nature and some characteristics of electronic commerce as follows “any form of business transaction in which the parties interact electronically rather than by physical exchanges or direct

¹¹² Report of the Electronic Expert Group to the Attorney General (Australia), 'Electronic Commerce: Building the Legal Framework', 1998, available at www.law.gov.au/aghome/advisory/ecag/single.htm

¹¹³ *ibid*

¹¹⁴ Davies (1998), Computer Program Claims, EIPR, at 429

physical contact.” That does not stop European Member States to adjust or adapt their electronic commerce perspective. For instance, in 1998 the Dutch Ministry of Economic Affairs published a policy paper identifying what electronic commerce covers as “all business transactions that are carried out electronically with a view to improving the efficiency and effectiveness of market and business processes.”

An interesting approach to define electronic commerce was produced by Basu¹¹⁵. In order to consider how to best define, he considers the elements of its infrastructure; the technological infrastructure to create an internet marketplace, process infrastructure to connect the internet marketplace to the traditional marketplace and infrastructure of protocols, laws and regulation. This approach signifies the necessity for cooperation between different forces and trends; it is not simply a legal issue, but nor is it a mere technological matter. Thinking of the Internet’s infrastructure, one question that comes up is who is responsible for it? Is there a State or an organisation responsible to keep it functioning? Can someone “switch it off”? The recent event of the previous Egyptian Government “shutting down”¹¹⁶ the internet in the whole country was unprecedented but indicated the separation of the different layers. However, what happened in Egypt, where the Government had very strict control of the rather small number of ISPs and

¹¹⁵ Basu. (2003) "Implementing Electronic commerce Tax Policy (Consumption Taxation)" 18th Annual BILETA Conference. Queen Mary, University of London. Available at: <http://works.bepress.com/subhajitbasu/35>

¹¹⁶ Egypt cuts off internet access, <http://www.guardian.co.uk/technology/2011/jan/28/egypt-cuts-off-internet-access>

ordered them to switch off, is not as easy or as feasible to happen in a Western country, where ISPs could be located in many different places, and sometimes in other jurisdictions.

These layers start with the physical infrastructure, the formulation and function of the data network. Different countries have bodies responsible for the management of the internet; however Internet is representing an arena evident globally and has no actual government responsible for it. Different bodies, such as Universities, corporations or institutions like the ICANN¹¹⁷, have responsibility for some specific elements within Internet, or have responsibility for their Intranet. Another part of the physical infrastructure is what equipment each user has to gain online access; so partial ownership of the physical infrastructure comes down to the individual user who bought a Smartphone or a personal computer. And another part belongs to the telecommunication companies, who have ownership of the physical routers and miles of wires used to transfer the information. The service element refers to the interface between network and the customer, mainly the ISPs. The majority of the data will be hosted and transmitted by the ISP-owned servers. It is this second element which most users will associate as being responsible for the Internet. Electronic commerce, whether direct or indirect, originates from technological development and its components are

¹¹⁷ Internet Corporation for Assigned Names and Numbers , <http://www.icann.org/>

meant to work within such an arena. The last characteristic is very important for those responsible with developing and imposing regulation on electronic commerce; when the wanted is tax regulation applicable online, tax authorities should be aware of it.

3. Should electronic commerce be taxed?

Internet has certain characteristics that do not necessarily require state support or supervision, thus making it easier to develop not considering geographical boundaries and policies¹¹⁸. The technological elements of it allow the individual to take advantage of its many uses, either for purposes of education, commerce, or entertainment. There are different views on how or to what extent online environment and more specifically electronic commerce should be subject to tax regulation. This discussion has been taking place for a couple decades already; from the 1990s to current time¹¹⁹ and there have been distinctly different opinions on what the right answer is.

¹¹⁸ Rabkin J. And Eisenach J, (2009) The U.S. Abandons the Internet, (Wall Street Journal, October 2) <http://online.wsj.com/article/SB10001424052748704471504574446942665685208.html> (also, Rhoads C, U.S. Eases Grip Over Web Body, (Wall Street Journal, October 2, 2009) <http://online.wsj.com/article/SB125432179022552705.html>

¹¹⁹ McLure, Charles E. Jr (1997) Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws 52 Tax L. Rev. 269 , Ward, Burke T., and Janice C. Sipior.(2004) "To tax or not to tax electronic commerce: A United States perspective." Journal of Electronic Commerce Research 5.3 172-80.

Electronic commerce has already shown it has a significant growth potential. Online shopping is one of the fastest growing markets in Europe. With a total value of 44.7 billion Euros in 2003, the market grew by 221% to 143.7 billion Euros in 2009¹²⁰. This figure has risen even further to an impressive 246 billion Euro in 2011 leaving North America behind for the first time on €237bn¹²¹. This impressive degree of growth can be identified by looking at the factors being always present in an online transaction. Firstly there is the actual infrastructure, where technological advancements move incredibly fast, (it is evident there is a great degree of compatibility and interconnectivity between the numerous telecommunication platforms and different systems, reaching all the way to the end-user's piece of personal equipment). The part of electronic commerce providing the means for the transaction between the vendor and the consumer from the pre-order to the delivery (especially in the case of intangible goods and services) is the services part. With the actual technology in place and the service element allowing for the process and delivery of information, the other element which allows growth is the legal one. It affects the relationship and cooperation of the different actors in

¹²⁰ PressDK (2011) European online commerce will develop in 2010 - Online shopping grows 20% while overall retail sales only increased by 1.4%, Published February 10, 2010 by <http://presse.kelkoo.dk/europ%25C3%25A6isk-online-handel-vender-udviklingen-i-2010-online-shopping-v%25C3%25A6kster-20-mens-den-overordnede-detailhandel-kun-stiger-med-14.html> (March), (http://translate.google.cdm/translate?js=y&prev=_t&hl=da&ie=UTF-8&layout=1&eotf=1&u=http%3A%2F%2Fpresse.kelkoo.dk%2Feurop%2525C3%2525A6isk-online-handel-vender-udviklingen-i-2010-online-shopping-v%2525C3%2525A6kster-20-mens-den-overordnede-detailhandel-kun-stiger-med-14.html&sl=auto&tl=en)

¹²¹ Emota (2012) "Europe Confirmed as Leader in Global electronic commerce" 01 June 2012, <http://www.imrg.org/ImrgWebsite/User/Pages/Press%20Releases-IMRG.aspx?pageID=86&parentPageID=85&isHomePage=false&isDetailData=true&itemID=7685&specificPageType=5&pageTemplate=7>

electronic commerce, whether they are a public body, a limited company or simply an individual consumer; it provides certainty or specific frameworks for those involved to perform their role. When considering the interaction of electronic commerce and tax, one realises how significant and accurate the legal aspect must be. All three aspects, the infrastructure, the service and the legal need to work together in order to enable electronic commerce to develop further.

Electronic commerce has no physical geographical boundaries, and thus within cyberspace any distance is eliminated, it is global. Electronic commerce is characterised to an extent by greater “virtual” presence compared to actual physical representation. The same is also applicable to the human intervention necessary for electronic commerce, as well as the minimum documentation or depending on the circumstances lack of actual documentation regarding an online transaction. Intermediaries in traditional commercial transactions have specific part to play in the process, however in electronic commerce there is evident the reduction of intermediaries, as well as the deficiency of actual physical control over it. Another significant difference between traditional methods of commercial transactions and electronic commerce is the fact that while conducting business online, the transactions can be anonymous; no face-to-face direct contact between seller and consumer.

So, if electronic commerce is significantly different to conventional commercial activity there are questions of why should it be taxed and a very significant point is who is able or suitable to regulate? Cyber libertarians have been arguing from the birth of the internet that it should be free of any regulation by governments¹²². Internet by its initial concept and nature was not directly owned by anyone, it represented an “open self-regulating society”; so who has the right to collect taxes from any activity within the sphere of the internet? Historically new developments would cause some minor or major problems to the law and regulatory mechanisms; the view usually being followed is try to apply existing laws to the new development¹²³. But it is not always so easy or appropriate to take such an action; when the law is reacting to a new challenge a lot of careful consideration and planning is necessary to ensure the specific regulation is what fits that specific development. Saxby has commented that “The law is at a stage when it is trying to bed down a technology that has re-shaped society to its roots.”¹²⁴

¹²² Lessig Lawrence, (1999) “Code and Other Laws of Cyberspace”, Basic Books

¹²³ Rowland D, (1998) “Cyberspace - A Contemporary Utopia?”, The Journal of Information, Law and Technology (JILT), 1998 (3), <http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/1998_3/rowland/>

¹²⁴ Saxby S, (1995) “A Jurisprudence for Information Technology”, <<http://www2.echo.lu/legal/en/access/saxby/ch1/ch1.html>>

3.1 One set of rules or “real” & “virtual” rules separately?

In order to identify challenges to electronic commerce taxation we have to look at the different types of taxes potentially relevant to the online platform. First we have the indirect VAT sales and consumption taxes and secondly the direct income and corporation taxes. For instance, a very simple illustration is that when a resident of the city of Rome or the city of London, for example, buys a product he or she will pay an X amount extra, which will be already inclusive in the price, to cover the tax of the product. But the difference is while a purchase in Italy and the United Kingdom will incur a levy of 20% VAT, in Greece it is 23%, in Luxemburg it is 15% and in Sweden it goes up to 25%. Within EU there is no actual harmonized tax system among its members; depending where a person resides will mean paying more or less for a product.

One distinction worth mentioning is the distinction between direct and indirect electronic commerce. When talking about direct we refer to the supply of virtual goods, in other words electronic ordering and the subsequent electronic delivery of the ordered product or service. When on the other hand we mention indirect electronic commerce we are referring to the electronic ordering and the subsequent physical delivery of the goods. Indirect electronic commerce is much easier to identify and regulate, as the route of delivery for the product will be via conventional methods of the

post or a courier. Direct electronic commerce on the other hand presents more challenges to online regulation general and more for the purposes of this work taxation within the remit of electronic commerce.

So can the same rules simply be transferred and be applicable to the online commercial activity? Some academics believe that the existing tax rules should be applied to electronic commerce.¹²⁵ The suggestion is that the internet is simply a new stage where already existing law can apply; a case presenting new facts which can be resolved with existing law. If someone rents a DVD to watch a movie, and if someone else downloads the movie to watch, what is the difference between the two? Is it a new product, or merely different channels of delivering the same product? What it amounts to is the same product, because the nature or character or use of the item is not altered; so, that may indicate existing tax rules could be applied to electronic commerce activity, or it may also indicate that electronic commerce presents a very radical change in the taxation perspective and completely new rules need to be devised.

¹²⁵ Basu Subhajit (2004) 'To tax or not to tax? That is the question? Overview of Options in Consumption Taxation of Electronic commerce', 2004(1) The Journal of Information Law and Technology (JILT), http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu

The predominant idea is that electronic commerce is in many ways different than traditional commercial activities, and this chapter attempts to review the challenges presented to the various taxing authorities; for instance, Inland Revenue in UK, or the Internal Revenue Service (IRS) for the United States, public bodies who are responsible for administering their tax system. These authorities, similarly all authorities dealing with e-commerce taxation, will have to bear a significant degree of responsibility to adapt adequately to any potential adjustments in order to tackle the challenges in taxing electronic commerce. Before we go into the main challenges and the regulation in place to tackle these challenges it is important to identify the main theoretical perspectives that shaped regulation and policy of consumption taxes on electronic commerce. The two main ones are the Cyber-libertarianism and Cyber-skepticism.

3.2 Cyber-libertarianism

In a 1997 paper Professor Langdon Winner was one of the first academics to publish in regard to information technology and its regulation using the term "*cyber-libertarianism*"; what the term meant is described as "*a collection of ideas that links ecstatic enthusiasm for electronically mediated forms of living with radical, right wing libertarian ideas about the proper definition of freedom, social life, economics, and*

politics in the years to come."¹²⁶ In the 1990s there was the widespread notion that cyberspace could perhaps be able to challenge the status quo, the framework of a regulated nation-state, to a post-boundaries perception of society¹²⁷. Dibbell argues that cyberspace needs no interference from the State, as self-regulation will prove more efficient and suitable for the new form of borderless world. His work had such a significant impact on thinkers at the time, that even Professor Lessig said in a review of Dibbell's work in 2005 "*Dibbell's story is why I teach cyberlaw*"¹²⁸

Alongside Dibbell, another very influential figure raised the idea that cyberspace is very different and it should not simply be considered a development on conventional systems, trying to bring forward his argument for a separate legal regime for cyberspace; he is the co-founder of the Electronic Frontier Foundation¹²⁹ advocating freedom and protection of user rights online. Their idea of decentralised and not-interfering State meant that the only possible avenue for any regulation would have to be a self-regulatory model, originating from the internet itself¹³⁰. However, at the same time the rise of an opposite ideology that Internet can and should be operating within a

¹²⁶ Winner, Langdon. (1997) "Cyberlibertarian myths and the prospects for community." ACM SIGCAS Computers and Society 27.3: 14-19.

¹²⁷ Mainly through the works of Julian Dibbell (1993) "A rape in Cyberspace; how an evil clown, a Haitian trickster spirit, two wizards, and a cast of dozens turned a database into society", Village Voice (http://www.juliandibbell.com/texts/bungle_vv.html)

¹²⁸ Reviews of My Tiny Life, <http://www.juliandibbell.com/mytinylife/tinyreviews.html>

¹²⁹ <https://www.eff.org/>

¹³⁰ Johnson D and Post D (1998) "The New Civic virtue of the internet. " (Emerging Internet)

legal and policy framework; the cyber paternalists. Their initial view was that cyber libertarianism was arguing an overly simplified point, considering Internet as not connected to social and political phenomena¹³¹. Along the same principles “Lex Informatica” argued that Internet cannot be completely anarchic and without regulation, as there is already regulation inbuilt in its architecture¹³².

3.3 Neutrality

The international tax framework by OECD¹³³, which will be discussed in the following chapters, presents significant guidelines or principles which include neutrality, equity, fair share of revenue, and administrative efficiency.¹³⁴ Neutrality is one of the four, and it is important because it does not allow discrimination on taxation as long as the product is the same. Taxation rules should not be decisive on whether a consumer buys a watch online or at the shop. This principle of neutrality in applicability to electronic commerce is also reflected in the U.S. Treasury’s Discussion Paper on "Selected Tax Policy Implications of Global Electronic Commerce": *“In order to ensure that these new*

¹³¹ One of these critics was Reilly Jones who published (1996) “A critique of Barlow’s ‘A Declaration of Independence of Cyberspace’”, *Extropy* #17 Vol.8(2)

¹³² Reidenberg J (1996) “Governing Networks and Rule-making in Cyberspace”, 45 *Emory Law Journal* 911. Reidenberg J (1998) “Lex Informatica; the formation of information policy rules through technology”, 76 *Tex L Rev* 553

¹³³ OECD (1998) “Electronic Commerce: Taxation Framework Conditions” (A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference “A Borderless World: Realising the Potential of Electronic Commerce” on 8 October 1998), Available at <http://www.oecd.org/dataoecd/46/3/1923256.pdf>

¹³⁴ Doernberg R et al, 2001, *Electronic Commerce and multijurisdictional Taxation*, 33

*technologies not be impeded, the development of substantive tax policy and administration in this area should be guided by the principle of neutrality. Neutrality rejects the imposition of new or additional taxes on electronic transactions and instead simply requires that the tax system treat similar income equally, regardless of whether it is earned through electronic means or through existing channels of commerce.”*¹³⁵ The technological neutrality principle means the law must not explicitly and restrictively mention certain technologies used in electronic commerce. There should be a framework ensuring equal treatment between traditional shopping and online shopping, so as not to offer one an unjust advantage over the other.

4. Challenges electronic commerce poses for taxation

First of all, the nature of Internet and more specifically its commercial part has shown rapid growth in the last few years. Electronic commerce has an international nature, it is inherently non-territorial. The lack of geographic boundaries has helped increased the amount of electronic commerce activity; small-sized companies can become international players by using electronic commerce. Because we are looking at what is a worldwide process, there is the issue of jurisdiction arising. Taxation is dependent upon,

¹³⁵ Selected Tax Policy Implications of Global Electronic Commerce (Nov. 22, 1996) Department of the Treasury Office of Tax Policy at <http://www.treasury.gov/resource-center/tax-policy/Documents/internet.pdf>

or rather is interrelated with the issue of establishment, for a tax to be imposed on a transaction, the authority that has the role of collecting the taxes has to know where it took place. Also, it should be recognisable whether the category in question is goods or services; if not clarified then there may be cases of double-taxation. But the relevant and appropriate jurisdiction cannot always easily be identified. The worldwide nature of electronic commerce also creates another issue; that of anonymity. Business is not transacted on a face to face basis, customer can hide his identity easily, and this may eventually lead, or simply facilitate to an extent, fraud or even tax evasion. Internet Service Providers (ISPs), content providers, hosts, end users, they all may be located in one or more different jurisdictions. Thus, there is an ambiguity to the principle of origin and destination as well.

4.1 Jurisdictional matters

As geography is material to determination of both direct and indirect taxes, basic elements of fiscal sovereignty are rendered problematic by the electronic commerce especially those carried out over the internet and other virtual platforms¹³⁶. The network is a borderless medium that, in many contexts, ignores sub-federal or federal

¹³⁶ Annette Nellen, (2001) 'Electronic commerce: To Tax or Not to Tax? That is the Question ... Or Is It?', Computer and Technology Law Conference", San Francisco June 29, 2001

geographic jurisdictions¹³⁷. Traditionally, consumption taxes – sales, use and value added tax – are assessed at the place where the good or service is actually consumed.

Income taxes are more complex, but also geographically based. Thus a country (or state) may tax all income which arise within its boundaries, the income of residents of that jurisdiction regardless of where they are physically located, or that of permanent establishments (fixed places of business) located or doing business within its territory¹³⁸.

There does not necessarily have to be any geographic connection between the producer of electronic commerce goods or services and the consumer. The ease of accessing distant markets facilitates remote economic activity¹³⁹ which creates problems for local, state or federal tax authorities that may have difficulties imposing (or enforcing) their taxes on economic activities that take place outside of their geographic jurisdictions¹⁴⁰.

For example, a small online business in Aberystwyth can sell its goods or services to an international audience by simply posting a webpage that can be viewed by customers

¹³⁷ Stephen J. Kobrin, (2001) 'Territoriality and the Governance of Cyberspace' (2001) Vol. 32, No. 4 Journal of International Business Studies, pp. 687-704.

¹³⁸ Adrian J. Sawyer, (1999) 'Electronic Commerce: International Policy Implications for Revenue Authorities and Governments' Virginia Tax Review, Vol 29 -1999, 73-112; http://papers.ssrn.com/sol3/papers.cfm?abstract_id=209708

¹³⁹ Karl Frieden, (2000) 'Cyber taxation: The Taxation Of Electronic commerce' (CCH Incorporated, 2000)

¹⁴⁰ Arthur J. Cockfield, (2002) Designing Tax Policy for the Digital Biosphere: How the Internet is Changing Tax Laws, vol. 34 Connecticut Law Review pp. 333-403

located anywhere in the world, as long as the customers have access to the Internet. The tax systems of most countries, United Kingdom inclusive, were developed when trade and capital movements were limited, and are thus ill-suited for an integrated world economy¹⁴¹. However, the characterization of the network as a global forum may be somewhat misleading on certain grounds.

The Internet and associated economic activities are often portrayed as global in nature, the producers of the underlying goods, services and information may still need to be clustered within certain countries or within specific regions within countries¹⁴². It must therefore be conceded that whilst electronic commerce allows goods and services to be available to a global market, all such goods and services are produced in particular jurisdictions. Hence, tax principles that focus taxation of profits on the location of production have greater prospects of implementation even to “clicks and mortar” companies¹⁴³. Many are of the view that the real solution lies in multilateral or global

¹⁴¹ Vito Tanzi,(1996) ‘Is There a Need for a World Tax Organization’, International Institute of Public Finance, Tel-Aviv, August 1996

¹⁴² OECD, Understanding The Digital Divide (2001), < <http://www.oecd.org/internet/interneteconomy/1888451.pdf>>; UN Dep't Of International Economic & Social Affairs, UN Model Double Taxation Convention Between Developed And Developing Countries, U.N. Doc. ST/ESA/PAD/SER.E/21, U.N. Sales No. E.01.XVI.2 (2001); OECD Electronic Commerce Report, supra, p.29.

¹⁴³ Collin Lau, et al,(2003) ‘From Electronic commerce to E-Business Taxation’ Asia-Pacific Tax Bulletin, p.7.

cooperation compared to national or local approaches which will take adequate care of the competing and conflicting interests of developed and developing countries¹⁴⁴.

4.2 Anonymity

Anonymity is a concept closely related to the Internet, due to the nature of the transaction taking place without the need of the seller to meet the consumer. The way anonymity is seen as a challenge to electronic commerce tax, is the sense that the electronic commerce transaction, its parties, and its details are at least partially anonymous or require intensive investigation to discover its parties and details. However, the different types of electronic commerce (B2B and B2C tangible &/or digital products) differ in terms of the extent to which each of them is anonymous or has a virtual nature. Generally speaking, electronic commerce involving tangible products is not virtual, not to the extent electronic commerce in intangibles and electronic commerce in services are. This difference has tax ramifications - as the global and virtual elements of electronic commerce increase, the tax challenges become more intense. Likewise, anonymity is always present to some extent but varies between the different

¹⁴⁴ Oduntan, Olugbemi Adebayo, (2010) Taxation of Electronic Commerce: Prospects and Challenges for Nigeria (August 2010). <http://ssrn.com/abstract=1697998> or <http://dx.doi.org/10.2139/ssrn.1697998>

types of electronic commerce and the necessity for information to be passed on from one party to the other.

The level of anonymity depends on the architecture of the Internet and on the available locations technologies. As the level of anonymity increases, the tax challenges become more complex. An example of anonymity can be seen by PayPal. To use PayPal a consumer needs to register, provide all the details, but the seller does not get any of these details, so the seller knows what the address is because PayPal gives them the information, but even then it is not known if it is home or work address or someone else's. Generally anonymity is not possible to a great extent. There are tools to be used if people purposefully want to attempt and hide their identity, such as an anonymous FTP, a service allowing the user to gain free access without the need for passwords. Some appraise the existence and need for anonymity on the internet and even during electronic commerce transactions still attempting the utopia of cyber libertarianism. However many supporters anonymity or its online pursue has, it can carry considerable and alarming implications for social interaction online and regulation, especially in the aspect of electronic commerce taxation, where the need to identify seller's and buyer's whereabouts is paramount.

4.3 Determining Place of Supply; the importance of Permanent Establishment

One of the major points of discussion in relation to electronic commerce taxation is the principle of Permanent Establishment (PE). The notion of PE is very important in source taxation. Without PE, a country cannot claim jurisdiction to tax profits resulting where goods or services are sold. A PE is a “fixed place of business through which the business of an enterprise is wholly or partly carried on”¹⁴⁵. But the challenge of this definition is to fit within the electronic commerce context. PE requires something “fixed”, attached to a geographical place. Within the context of electronic commerce there cannot be bricks and walls. The permanent establishment guidelines were presented in the ones falling within the wording of Article 5 of the OECD model Convention, where they took the view that a website cannot constitute a PE, which means that countries cannot profit from website businesses but can only impose a levy on enterprises which have a fixed establishment in that country. Thus, from the perspective of tax administration, the principal challenge remains how to implement geographically limited taxing systems in a technologically advanced environment that makes geographical borders and limitations essentially irrelevant.

¹⁴⁵ OECD, Model Convention, Art.5

4.4 Digitization; Goods or services?

As mentioned previously internet brought about the alteration of the nature of products, especially the products that could be transformed into a digital version of what they were. For example a book has been to an extent replaced by e-books, especially the last couple years with the sales of e-readers increasing.¹⁴⁶ This change has severe implications for traditional consumption taxes, which were developed under the premise of a physical presence in a tax jurisdiction. A large number of countries in the world that impose Value-Added Tax (VAT) on the supply of goods and services are facing the same problem of trying to carefully categorise intangible products as goods or services.

The EU Commission agreed that supplies of digital products must be classified as services even if such products would, if delivered in their tangible form, be treated as goods for VAT purposes.¹⁴⁷ Particularly in the case of software and music or video products, which can be downloaded or e-mailed directly to customers via the Internet in digital or electronic format, the similarity is close enough to create some confusion. According to the VAT Directive a supply of service can be a) the assignment of intangible

¹⁴⁶ <http://www.usatoday.com/life/books/news/story/2012-01-09/ebooks-sales-surge/52458672/1>

¹⁴⁷ Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee "Electronic Commerce and Indirect Taxation" COM (1998) 374 final, Section V, Guideline 2

property, whether or not the subject of a document establishing title, and b) the obligation to refrain from an act, or to tolerate an act or situation.¹⁴⁸ Art 25 is concise but could be clearer on the elements of what is supply of services. Electronic commerce and the digitised form of products present another challenging task to tax authorities, firstly to categorize the character of the product and then to identify the framework for the transaction to take place.¹⁴⁹ The case of Napster has showed that digitised entertainment is specific volumes could be problematic for tax and legal authorities, as publishers of video games or music consider the download of music or a video on the hard drive as exactly the same as buying the hard copy.¹⁵⁰ These matters can present problems in consumption taxation as well as add the element of vagueness to whether the income generated in these transactions is classifies as business profits or as royalties paid for the rights in the music or the video game.¹⁵¹

4.5 Dominance by a few players

The lack of geographic boundaries has helped increased the amount of electronic commerce activity; small-sized companies can become international players by using

¹⁴⁸ VAT Directive, Art. 25

¹⁴⁹ Tillinghast David, (1996)The impact of the internet on the taxation of Informational Transactions, 50 Bull. Int. Fisc. Doc. 524

¹⁵⁰ A&M Records v Napster, Inc. 239 F.3d 1004 (9th Cir. 2001)

¹⁵¹ The OECD Model Tax Convention and Discussion on its relevance to electronic commerce ,<http://www.oecd.org/tax/treaties/35869032.pdf>

electronic commerce. But at the same time it provided a few players with the freedom to dominate the online commercial arena. Companies such as Amazon, Google, eBay, PayPal are more likely to have the resources to be tax compliant and deal with reasonable administrative burdens. A relatively recent example is Wal-Mart, being a late-comer to electronic commerce but having the capital and the expertise to set up and be near the top very quickly.¹⁵²

The electronic commerce marketplace is extremely competitive and the sheer size of it does offer opportunities but also adds more to the competition.¹⁵³ Is the reason these players are taking the biggest part of the revenue because they were first in?¹⁵⁴ The nature of the Internet and the development of electronic commerce did not allow for everyone to enter in the beginning. Not everyone had the technical knowledge and expertise to establish online trade in a new environment. And other reason is the fact that only some people took advantage of the new “place”, Internet, and showed leadership. For instance, it is riskier for a firm to enter a market in times of uncertainty. In case the market develops in the way that the pioneer or first mover has anticipated,

¹⁵² Kelly Evans, (2010) “How America Now Shops: Online Stores, Dollar Retailers (Watch Out Walmart),” The Wall Street Journal, March 23, 2010

¹⁵³ Kamel Mellahi, Michael Johnson, (2000) "Does it pay to be a first mover in ecommerce? The case of Amazon.com", Management Decision, Vol. 38 Iss: 7, pp.445 – 452

¹⁵⁴ Cady, J.F (1985), "Marketing strategies in the information industry", in Buzzell, R.D (Eds),Marketing in the Electronic Age, Harvard Business School Press, Boston, MA,

then the pioneer will enjoy first mover advantage by being first to market.¹⁵⁵ However, if the market develops in a way that the first mover did not anticipate, it stands to lose significant market advantages, and because of that, if a firm waits until the uncertainty is resolved, then it can be sure that investments involved in going to market are more likely to pay off, even if it is a follower to the market.¹⁵⁶

Internet offers the ability to set up and operate relatively inexpensive public and private communication systems. Despite the opportunity presented, the competition on one hand and the increasing administrative burden on the other makes it more difficult for smaller e-business to establish themselves online.¹⁵⁷ The main problem to the small electronic commerce website owner is not the added cost of the VAT, since that is passed on to the consumer. It could be difficult for the e-vendor to keep up with the ever changing taxes all over the different jurisdictions and the different reporting and collecting mechanisms.¹⁵⁸ Another aspect that can be seen as challenging is the aspect of consumer trust on electronic commerce platform. Trust is a factor which if established with the consumer then the customer is likely to stay and return with you;

¹⁵⁵ Supra 71

¹⁵⁶ Golder, P.N, Tellis, G.J (1993), "Pioneer advantage: marketing logic or marketing legend", *Journal of Marketing Research*, Vol. 30 pp.158-70.

¹⁵⁷ Supra 66

¹⁵⁸ Holmes David, (2001) "Tax administrations in an electronic world", conference, Montreal, 2001. See: www.ae-tax.ca/langselect.html Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions, OECD

however, e-commerce still is regarded as dangerous by some. Amazon.com appeared online in 1995, and it was a few years before others could do the same at the same quality level.¹⁵⁹

5. Specific challenges electronic commerce presents to VAT

The impact of electronic commerce as a productive medium for generating profit and expanding market penetration is revolutionizing the standard business model as it stands today. The potential of growth is enormous and the development rate is increasing continuously. In the US alone, which is the largest electronic commerce market¹⁶⁰, online retail even during economic recession reached \$133.6 billion in 2008¹⁶¹, a very significant increase from \$22 billion in 1998.¹⁶² Businesses, under the right circumstances, that have acted fast enough to embrace electronic commerce now find themselves one step ahead of their competitors, allowing them to establish market leader positions, and benefiting from a rising learning curve and electronic commerce acceptance. But with that great advancement, came certain significant challenges too.

¹⁵⁹ KABIR SEHGAL, (2006) How Understanding Trust Benefits Electronic commerce, http://www.lse.ac.uk/collections/informationSystems/iSChannel/iSChannel2006/Sehgal_2006.pdf

also see <http://www.zdnet.com/blog/btl/amazon-named-americas-most-trusted-and-recommended-brand/31106>

¹⁶⁰ Office of Technology and Electronic Commerce (US Dept. of Commerce International Administration) 2009, [http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/\\$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%2016.pdf](http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%2016.pdf)

¹⁶¹ Jeffrey Grau, (2009) Electronic commerce in a recession: The impact on Consumers and Retailers, eMarketer, May 2009

¹⁶² Peter Coy, (1998) You aint seen nothing yet, Business Week, June 22, 1998

The electronic commerce effect has resulted in certain aspects of conventional commerce being reconsidered; one of these aspects is taxation. Tax policymakers have a lot to adapt and adjust if they want to be efficient and updated as far as electronic commerce is related, so that lost tax revenue from electronic commerce is as minimal as possible. But what are the main challenges in relation to tax? To look at the specific challenges, the discussion will first consider the types of tax which are affected by electronic commerce and the implications for traders, before considering the general challenges.

5.1 To Income Tax

It was mentioned above that corporation's tax is similar to income tax; the difference is the level on which it is applicable. The similarities are evident from the consideration of discussing corporation tax and the potential tax liability of the individual shareholder. Electronic commerce makes it easier for business to be conducted without creating the "permanent establishment" that would otherwise subject a seller to tax on income. It

blurs the distinctions between the sale of goods, the provision of services and the licensing of intangible assets, each of which is subject to some form of taxation.¹⁶³

Source of income concepts play a central role in international taxation since the country of source generally has a right to tax income and the reason it needs to be mentioned is because it generates more revenue than any other taxes for a government. In general, the source of income is located where the economic activities creating the income occur. So the issue here remains similar as mentioned before; the challenge of finding where the economic activity occurs so as not to allow tax evasion by an online trader. All individuals must pay capital tax on capital gains, and collection on income tax takes place on the source by direct assessment¹⁶⁴ Taxes are imposed on the whole income of any person¹⁶⁵ and to ensure the correct amount has been paid for a fiscal year all the different sources need to be accounted for. If the individual operates an electronic commerce business, for which no tax is accounted for him acquiring the profits and no registration has taken place, then the state is losing revenue from more than one potential tax payers. For instance, the criteria for an individual to be subject to income

¹⁶³ Bird, Richard M., and J. Scott Wilkie, (2000) "Source vs. Residence-based Taxation in the European Union: the Wrong Question?" in Sijbren Cnossen (ed.), *Taxing Capital Income in the European Union: Issues and Options for reform* (Oxford: Oxford Univ. Press), pp. 78-109.

¹⁶⁴ PAYE, bank and building society interest, dividend income.

¹⁶⁵ <http://www.hmrc.gov.uk/leaflets/c9.htm>

tax within the UK are if they are resident or ordinarily resident in the UK¹⁶⁶. Generally, the income tax will be imposed on the whole income of any person tax resident in the country, and on income arising within the country of anyone not resident. Cases of small vendors carrying online business have been on the rise the last decade, especially in the beginning of operation of eBay, the well-known auction website.¹⁶⁷ The possibilities available due to electronic commerce create another challenge for income taxation; it is difficult to classify transactions as having an outcome strictly same to before. Electronic commerce has made it difficult to classify the transaction in the classical categories of “trade income” or “services income.” The standard categories anticipated products, services, and businesses that predate ecommerce, but the current age is different. Electronic commerce cannot be easily classified according to the old transactional categories.¹⁶⁸

5.2 To VAT

The aspects in regard to VAT will be mentioned here but discussed at later chapter in more detail, as it is the main tax studied for the purpose of this thesis. The reason for

¹⁶⁶ ITA 2007, s. 829

¹⁶⁷ See <http://www.telegraph.co.uk/finance/yourbusiness/8573216/HMRC-targets-eBay-tax-dodgers.html>, <http://www.guardian.co.uk/money/2012/may/01/ebay-traders-hmrc-tax-spotlight>

¹⁶⁸ Clayton Chan, (2000) Taxation of Global Electronic commerce on the Internet: The Underlying Issues and Proposed Plans, 9 MINN. J. GLOBAL TRADE 233, 255; also, Arthur J. Cockfield, *The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles*, INT’L BUREAU OF FISCAL DOCUMENTATION BULL. 606, 613 (2002)

this is consumption taxes, and VAT specifically, is wide-spread amongst most of the OECD members and it represents the most challenges towards traditional concepts of taxation and the need to examine viable solutions now as the Internet and electronic commerce are showing unparalleled growth rates, especially in relation to the fact the average consumer is having better and more convenient technology to go online and purchase a book, music or credits for an online game, even fresh grocery.

VAT is a European-developed tax and the European origin signifies its importance within the EU boundaries and of course now extending outside of them too, as it has turned from a European concept to a tax regime used in many jurisdictions worldwide.¹⁶⁹ The reason VAT was initially established was in order to formulate the environment of an efficient single market within all Member States.¹⁷⁰ Consumption taxes tend to be considered more stable and dependable than income taxes. The reason behind that perception is that the consumption base is less vulnerable than the income tax base; consumption expenditure tends to be more stable than income therefore it provides a more steady source of revenue. VAT is charged on the consumption of various products and services, such as electronic services, and the end-user of the service or product will

¹⁶⁹ http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/index_en.htm

¹⁷⁰ http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/index_en.htm

pay the VAT by reference to the value of that service or product.¹⁷¹ It is considered an efficient way for governments to raise revenue.¹⁷² The consumer is who will bear the tax, and that follows on from the initial thoughts that taxpayers are charged because they are receiving public services afterwards¹⁷³ VAT is an indirect tax fully compliant with the destination principle; it aims to levy the consumption where it happens and not where it originated from. However not all goods and services are subject to this levy or to put it better, there are services and goods subject to zero levy, mainly due to social policy implications. In UK for instance such goods are certain types of food and books as well as exemptions relating to provision of health and education services¹⁷⁴

Applying VAT on electronic commerce transactions raises some key questions. Is there a clear distinction between supply of goods and supply of services when the purchase involves intangible goods equivalent to existing tangible ones in the market? Is the computer server enough to constitute a connection for that State to impose VAT? Does the IT infrastructure alone, establish Permanent establishment and what is the situation when human recourses are necessary to ensure operation of the IT equipment? Is VAT to be charged on a destination basis or an origin basis? In 1998, at the very beginning of electronic commerce consumption taxation was seen as the type of taxation more likely

¹⁷¹ See Directive n° 2006/112/EC and Value Added Tax Act 1994 (VATA 1994), s.1

¹⁷² Tait A, (1998) Value Added Tax International Practice and Problems (IMF)

¹⁷³ Terra B., (1998) The place of supply in European VAT, Kluwer Law International

¹⁷⁴ VATA 1994, Schedule 8

to create problems for tax administrations. The OECD did observe that “the problems concerning the application of consumption taxes are generally recognized as having more immediacy than the issues concerning direct taxation.”¹⁷⁵

To consider the potentially problematic relationship between electronic commerce and VAT, there has to be a clarification on the different categories of transactions. There are business-to-business¹⁷⁶ sales of digitised products, such as purchasing and downloading security and privacy software for the business from a business specialising in security software, as well as B2B transactions involving the sale of tangible property via electronic means, for example the purchase of computer terminals and IT equipment for the business from an online vendor. Also, there are transactions involving business-to-consumer¹⁷⁷ sales of digital products such as the purchase and download of music from iTunes, as well as B2C transactions involving the sale of tangible products from an online vendor, for example an individual consumer buying a laptop from Amazon.co.uk. In regards to tangible goods, tax authorities simply need to adjust the existing regulatory framework. An appreciation of this fact is the approach taken by EU, with the Directive

¹⁷⁵ OECD Committee on Fiscal Affairs, *Electronic Commerce: A Discussion Paper on Taxation Issues* (1998) [hereinafter *OECD Electronic commerce Discussion Paper*], at 18

¹⁷⁶ Hereinafter B2B

¹⁷⁷ Hereinafter B2C

97/7/EC, identifying such transactions on a similar basis to any other cross-border transaction involving tangible goods.¹⁷⁸

Therefore, the types of electronic commerce transactions presenting the challenges for VAT are the B2B and B2C sales of intangible products and not the sales of tangible products via the Internet¹⁷⁹. The main questions raised in regard to the online sales of intangible products are mainly ones of product characterisation as well as of applicable jurisdiction. The jurisdiction question, which jurisdiction can impose tax on the specific transaction, to an extent is answered by considering the OECD Framework suggesting VAT should be destination-based, but the tax authority needs to have jurisdiction over the online vendor to successfully establish the levy on B2C electronic commerce.¹⁸⁰ The jurisdiction issue can be a complicated one, as mentioned above and also in conjunction with the Permanent Establishment principle, where the State will be able to levy the change if there is sufficient evidence locating the Vendor and the premises necessary within that jurisdiction.

¹⁷⁸ Directive 97/7/EC, Distance Selling Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997L0007:EN:NOT>

¹⁷⁹ VAT Directive, Art 14(1)

¹⁸⁰ Electronic Commerce: Taxation Framework Conditions, 1998, <http://www.oecd.org/dataoecd/46/3/1923256.pdf>

The application of VAT will be determined to a large degree by how the product in question is characterised and where is the supplier located.¹⁸¹ For efficient taxation on a consumption transaction the authorities need to identify where it takes place and whether it is goods or services supplied. The location of the seller as well as the location of the buyer is often not made known to each other, presenting a degree of anonymity.¹⁸² Also, the potential difficulty for tax authorities to identify the supplier's physical location could allow tax evasion, since the place of supply of service is seen as the place where the supplier has their business or a fixed establishment associated with the business.¹⁸³ The supply of services between businesses is in principle taxed at the customer's place of establishment, while services supplied to private individuals are taxed at the supplier's place of establishment.¹⁸⁴

This distinction is made to clarify what is the status of the customer receiving the service. A distinction must be made between a taxable person acting as such, for instance a business acting in its business capacity, and a non-taxable person, which would be a private individual who is the final consumer.¹⁸⁵ This tax is not a personal tax,

¹⁸¹ Frieden, K. (2000). *Cybertaxation: The taxation of e-commerce*. Chicago: CCH Inc.

¹⁸² Basu, supra note 10, at part 1

¹⁸³ Forst, David L.(1999) Old and New Issues in the Taxation of Electronic Commerce 14 Berkeley Tech. L.J. 711 (1999)

¹⁸⁴ Council Directive 2006/112/EC, VAT Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0112:20110101:EN:PDF>

¹⁸⁵ *ibid*, Art.43

meaning it is not imposed on individuals, but it is imposed on commercial transactions, even though these persons will be accountable for the collection of VAT, as described in Sections 3 (1) of the VAT Act: “a person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act. Morse and Williams present some elements, which they argue must be in place before the VAT applies on supply. They say that VAT applies to “supplies or good and services for consideration other than exempt supplies in the EU (or in each Member State such as UK) by a taxable person as part of the economic activity of that person”¹⁸⁶. All these elements can be distinguished and analysed individually to give a better understanding of how VAT works and only after the status of the customer and the nature of the service are clarified, the supply location is identified for VAT purposes.

VAT regulation has taken the direction of the OECD in many of its key elements. The Framework Conditions presented at the Ottawa Ministerial Conference have been providing guidance in regard to consumption taxes.¹⁸⁷ Within the EU, being the first considerable tax jurisdiction to establish and apply a consumption taxation framework, there is evidence of adopting and developing the OECD principles. These principles

¹⁸⁶ Morse and Williams (2004) Davies: Principles of tax law, 5th ed Sweet & Maxwell

¹⁸⁷ OECD Electronic commerce Discussion Paper, p. 4-5

suggest that VAT should be levied in the jurisdiction where consumption takes place.¹⁸⁸ That would create a rather demanding task, considering it is digital products over electronic channels, for the tax authorities to determine destination location and ensure the mechanisms are established for tax collection in that jurisdiction. One of the other recommendations put forward by the OECD was the application of reverse charge or self-assessment for B2B transactions involving digital intangible products, in order to protect the tax base of the online traders.¹⁸⁹ This shows that the distinction and establishment of different means of tax collection between B2B and B2C transactions for intangible products was perceived as a key and potentially challenging matter by OECD.

An indication of the important role OECD has taken as a coordinator to these issues can be seen by the statement of the Clinton Administration's Deputy Treasury Secretary. Eisentstat said "Unilateral proposals, even though intended to be consistent with the OECD framework conditions, increase the risk of unintended consequences. They can undermine the OECD process and weaken the resolve of those who have been resisting unilateral measures while awaiting the results of that process".¹⁹⁰

¹⁸⁸ Ibid, at p.5

¹⁸⁹ Ibid, at p.5

¹⁹⁰ BNA Daily Tax Report, June 9, 2000, G-3.

As mentioned above in the case of supply of digital products it could be difficult for the seller to identify where the consumer is located. Since the products would be transmitted via electronic means there may be lack of documentation of the sale and any relevant electronic record, which could open the possibility of tax evasion and ultimately make enforcement of the regulatory principles difficult. Another potential challenge to tax authorities relating to VAT from electronic commerce is the administrative burden of compliance for the sellers as well as the tax authorities themselves. Generally, tax authorities could administer and collect VAT and other indirect taxes with considerably less hassle than a direct tax. The reasons were that there were usually a smaller number of taxpayers and also companies had to satisfy some requirements for registration, and thus compliance was perceived as easier.

However, electronic commerce brings a major shift in that perspective; tax authorities have to deal with a substantially larger number of consumers from worldwide, meaning that the people dealing with their tax system could be multiplied to those just residing in the specific state. The same problem applies to the online traders. By the nature of their trade and products supplied the destination of the supply could be anywhere, and the consumer could be in significantly different tax jurisdiction. Online traders could face significant bureaucracy by means of registering for VAT in the consumer's

jurisdictions and ensuring compliance with the specific tax regulations, potentially in a number of different countries with different VAT rates and collection systems.

6. Conclusion

Electronic commerce taxation should be approached on a fair and secure basis. There's no doubt that governments will not allow their tax revenues to evaporate because in practice revenue from consumption taxes still holds a major role in securing the funds for services governments need to provide to citizens. So electronic commerce taxation can be perceived as a normal part of the way governments operate. The challenges posed by electronic commerce for tax administration are quite significant and pose key questions to be answered. Even if the technical issues raised by electronic commerce can be resolved, there remain the political and policy questions, which in the end may be more demanding and formidable. The considerable efforts by the OECD and other governmental and non-governmental initiatives only indicate that the result is more likely to be in favor of the adoption of taxing regimes which will operate effectively in a cooperative manner between jurisdictions of e-commerce.

3. Taxation: the ‘Smithsonian canons’, key elements and the Internet

Contents

3. Taxation: the ‘Smithsonian canons’, key elements and the Internet.....98

1. Introduction	102
2. What is tax?.....	103
3. Taxation: a historic glimpse into its origins and development	108
4. Why tax?	114
4.1 How to tax? Adam Smith and the ‘4 canons’	116
5. Direct and Indirect taxation	131
6. Permanent Establishment.....	138
7. Consumption taxation.....	141
8. Origin and Destination principles.....	143
9. Conclusion	145

This chapter will provide an overview of taxation from a theoretical perspective to the vital fiscal aspect of any commercial transaction. It will start by considering the development of taxation from theory, looking also at the historical background, to a contemporary systematic procedure. The question of what is tax and its main characteristics will be answered, building upon the specific elements identifying the importance of tax in a commercial sense, conventional as well as online. The purpose of this chapter is to provide some background on the basis of tax and how they will associate with taxing e-commerce from a consumption tax perspective. This discussion will produce useful findings in order to study regulatory attempts for the online commercial transactions and their taxation. These attempts will have to consider, other than the current systems, the basics of taxation systems, starting from Adam Smith and the Wealth of the Nations, as well as the initial models on electronic commerce regulation, even considering the libertarian views of the “borderless” cyberspace and the regulation model put forward by Lessig¹⁹¹. The discussion will continue on the reasons and objectives behind a taxation framework. Has the rationale behind tax changed substantially to warrant complete overhaul when relating to electronic commerce transactions? This chapter will help identify the basis on which the foundations of the thesis main arguments will be established, namely the basic aspects of taxation and the principles behind them such as a distinction between direct and

¹⁹¹ Lessig L,

indirect taxation as well as one of the significant aspects of electronic commerce related taxation, the Permanent Establishment. In conclusion all the discussion of this chapter will provide useful assistance in identifying a parallel for the principles of a more accurate and efficient taxation for online commercial transactions.

1. Introduction

Tax systems are an essential characteristic of modern states used in order to generate significant amounts of revenue. In 2010 tax revenues accounted for 91% of total general government revenue in the European Union. Tax revenue made up 39,6% of GDP in 2010 in the European Union and 40,2% in the euro area.¹⁹² In the United States government revenue has constantly been increasing to reach about 35% of the GDP in 2010¹⁹³ These figures are clearly indicating the central role that taxation, in its varying formats, plays in the operation of a state and governments have spent significant political and intellectual capital debating and establishing tax reforms in different tax aspects¹⁹⁴. In practice, however, reform has been limited to only incremental changes to

¹⁹² epp.eurostat.ec.europa.eu/statistics_explained/index.php/Tax_revenue_statistics

¹⁹³ http://www.usgovernmentrevenue.com/revenue_history

¹⁹⁴ Cnossen, Sijbren, 2002, Tax Policy in the European Union (August 2002). CESifo Working Paper Series No. 758. Available at SSRN: <http://ssrn.com/abstract=340905>

the pre-existing systems. That is not to say of course that significant changes have not been made, some of which have assisted in further development existing taxes as well as in more modern elements of a tax regime.¹⁹⁵ Major reasons for investing in research of tax in different jurisdictions can be briefly identified as a globalisation of the capital and corporate entities, closer cooperation, both on a political and trade level, as well as the emergence of Internet and Electronic Commerce¹⁹⁶.

2. What is tax?

The first step before discussion of the historical background and fundamentals of taxation systems should be directed to the basic element; what is tax? The definition can be useful in providing a starting point on which to expand further by examining its principles and individual characteristics. One useful definition can be found at the words of former Chancellor of Exchequer and economist, Hugh Dalton. His definition of tax reads that *'a tax is a compulsory contribution imposed by a public authority, irrespective*

¹⁹⁵ For further details on the changes, especially within the Member States of EU see Devereux, M. P. (2004). Debating proposed reforms of the taxation of corporate income in the European Union. *International Tax and Public Finance*, 11(1), 71-89. An example is in relation to ecological and environmental tax, see Simon Dresner, Louise Dunne, Peter Clinch, Christiane Beuermann 2006 'Policies for Ecological Tax Reform: Assessment of Social Responses' (PETRAS), *Energy Policy*, Volume 34, Issue 8, May 2006, Pages 895-904, and Adarsh Varma UK's climate change levy: cost effectiveness, competitiveness and environmental impacts, *Energy Policy*, Volume 31, Issue 1, January 2003, Pages 51-61

¹⁹⁶ An IMF discussion of the main concerns of tax reform in emerging economies by Tanzi, Vito 1991 Tax Reform in Economies in Transition: A Brief Introduction to the Main Issues (March 1991). IMF Working Paper No. 91/23. Available at SSRN: <http://ssrn.com/abstract=884657>

*of the amount of service rendered to the taxpayer in return and not imposed as a penalty for any legal offence...*¹⁹⁷ Even back then taxation was recognised as an increasing necessity for the Government to be able to finance and meet the expenditure required for public welfare and other state activities. Dalton was a firm believer that Government should be gathering public revenue from '*a skilfully conducted public enterprise*'¹⁹⁸, indicating the need for setting up a very well structured and efficient framework for taxation.

To define adequately what tax is, there needs to be a rather specific point of view because any ambiguity can widen the spectrum endangering the definition to be too vague; it should be more precise to preserve the notion of an exact and strict definition. Another noteworthy definition is provided by James, who reads '*a compulsory levy made by public authorities for which nothing is received directly in return*'¹⁹⁹. From James's definition a few things can be observed. There is the idea of a payment made, but at the same time, in contrast to what is usually the case in other contractual, commercial transactions, there is nothing '*directly*' in return. The term '*directly*' as used in James's definition indicates a level of interaction between the state and the citizen. The citizen will be the party responsible for the payment of the tax, and that does not

¹⁹⁷ Hugh Dalton 1922, *Principles of Public Finance*, 17th Impression - 1948, Routledge & Keegan Paul Limited, p32 (Also discussed in R. Burgess 1993, *Public Revenue Without Taxation*, Shephard-Walwyn, p.39)

¹⁹⁸ Ibid, p33

¹⁹⁹ James 1998, '*Dictionary of Taxation*', E. Elgar

mean there will be an immediate and direct provision of services returned to the taxpayer. It represents a more general approach to gaining a benefit by assisting the state and thus allowing for economic stability and development, and it will subsequently be for citizens' enjoyment of services such as health services, road infrastructure, and schools²⁰⁰. The idea behind payment of taxes carries the notion that it is meant to be returned to the taxpayer by means of service provision by the state.

Another way to attempt to define what tax is, can be by trying to find the main characteristics. According to the discussion in the case of IRC v Océ van der Grinten²⁰¹ tax '*is a compulsory levy imposed by an organ of government for public purposes*'. This definition puts more emphasis on the legality of taxation by using the term '*compulsory*'; it is a legal obligation to pay taxes. As with the previous definitions above there is the political and policy involvement by identifying that taxes are paid for public purposes.

A rather discerning opinion is that of Auberon Herbert, a philosophic anarchist, who was of the opinion that taxation is not morally justifiable. That seems to be quite an eccentric and rare approach, indicating that his philosophical perspective was

²⁰⁰ Lymer A, Hasseldine J 2002 "The International Taxation System", Kluwer Academic Publishers

²⁰¹ Case C-58/01. *Océ Van der Grinten NV v. Commissioners of Inland Revenue* <http://curia.europa.eu/juris/showPdf.jsf?jsessionid=9ea7d0f130debc481ae670324aeca429a16d6ca5f4e9.e34KaxiLc3eQc40LaxqMbN4NchuLe0?text=&docid=71483&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=55819>

considering the State not as a structured institution, but a more abstract non-governed principle where citizens had no such obligations.²⁰² Morse and Williams try to attempt the definition of what tax is from a different point of view; by listing all the charges identified as taxes²⁰³. Such a task does appear to be a very laborious task and even if a list of all taxes within a specific jurisdiction is collected it may still not provide the accuracy such a task requires. A better approach is to collect information and list the major taxes, depending on their significance for the relevant jurisdiction, for instance calculating the amount of revenue they bring in. The International Bureau of Fiscal Documentation (IBFD)²⁰⁴ also provide their own view towards how to define what tax is, proposing that on one hand a tax should not include charges or penalties, but on the other hand it can include social security contributions. The reason for this distinction has to do with the fact that social security usually compulsory, unrequited payments to general government.²⁰⁵

Having a definition serves the purpose, as mentioned earlier, of having a starting point. The question of how accurate the definition is should be considered in accordance with the environment the tax operates in, whether it is related to domestic or international law, whether it is a sales-related tax or corporation tax. For instance within the

²⁰² Hugh Dalton 1922, *Principles of Public Finance*, 17th Impression - 1948, Routledge & Keegan Paul Limited, p32

²⁰³ Williams D, Morse G 2008 'Davies: Principles of Tax Law' Sweet & Maxwell

²⁰⁴ <http://www.ibfd.org/>

²⁰⁵ Lymer A, Hasseldine J 2002 "The International Taxation System", Kluwer Academic Publishers, p3

European Union, different Member States have their own tax systems and to a certain degree have their own understanding of what tax is and its main principles and aims²⁰⁶. On the other hand, there need to be some ground rules to allow cohesion in tax policies and some degree of coordination on taxation²⁰⁷. To understand taxes that will be imposed on a business or an individual, one has to understand the national tax laws of that country, as to an extent they will be associating with the culture of that country. As economic integration within the European Union moves further forward, the interactions between the tax systems of the Member States are of growing importance.

Another definition worth considering as it presents a different approach is the one found in the dictionary. The Shorter Oxford English Dictionary defines taxation as ‘the *imposition or levying of taxes; the action of taxing or the fact of being taxed*’²⁰⁸. This definition emphasises on the dichotomy of ‘*fact*’ or ‘*action*’. The first could be relating to the perception of taxes by the taxpayer, while the second one to the planning and policy aspects from the side of the taxing authorities. Both these perspectives, alongside the elements from the aforementioned definitions, are providing useful insight on how tax can be defined. These different definitions indicate another potential problem; they

²⁰⁶ For a comprehensive analysis of the tax rules that apply between independent countries and between the constituent parts of a federation, see Musgrave (1983), McLure (2001) and Boadway (2001).

²⁰⁷ For a better discussion of the interactions between the tax systems of Member States of the European Union see Cnossen, Sijbren, Tax Policy in the European Union (August 2002). CESifo Working Paper Series No. 758. Available at SSRN: <http://ssrn.com/abstract=340905>

²⁰⁸ Shorter Oxford English Dictionary, 2007 - 6th edition, volume 2, OUP

have common principles but are not the same. Considering the wide-reaching implications that such a generic tax definition would be encompassing, it seems logical to not have a very specific definition covering all perspectives. Different jurisdictions, global nature of many commercial transactions, electronic commerce can all identify the basic meaning and functions of tax from very different perspectives, therefore all is needed is a few widely accepted principles. There are disparities between conventional and online commerce, but there are also similarities identifiable to both. This discussion and the ensuing thoughts will be very useful in examining the tax issues in relation to electronic commerce and assisting in developing the arguments throughout the thesis.

3. Taxation: a historic glimpse into its origins and development

Another way to appreciate its significance and make taxation more efficient is to understand its original objectives, how it emerged and developed to its current contemporary form. Taxation has existed for many centuries in different formats²⁰⁹. There was a system of taxes in Ancient Athens, with non-Greeks and slaves ultimately paying more than the Athenians. Subsequently, the Romans developed a substantial taxation framework allowing the individuals dealing with taxes to acquire enormous (for

²⁰⁹ A short introduction to word's taxation for over two thousand years is provided by Grapperhaus 1998 'Tax Tales From the Second Millennium (Taxation in Europe (1000 to 2000) the united states of america (1765 to 1801) and India (1526 to 1709))' IBDF

the time) amounts of money and at the time enormous power in their hands. There were tax systems evident even in theocratic empires like Ancient Egypt and China where people were made to pay taxes in the form of tribute to their leader or their God²¹⁰. Also, the UK taxation system as we know it now is a result from trying to find means to finance for the British to increase military and intelligence against Napoleon Bonaparte²¹¹. William Sampson, from University of Alabama, argues that taxation is something which appeared and got implemented at different times in different civilizations, putting it parallel to building of such architecture as temples²¹². Others argue that taxation is not simply a matter of economic management and governance, but it evolves around the idea of the state and aspects of society playing a very important role²¹³, and on the same line Brownlee presents a short history of the US federal taxation presenting all the social and economic factors that helped with its development²¹⁴.

Another argument amongst tax and history academics is the influence taxation may have had to the development of numbers and mathematics²¹⁵. One area that provided

²¹⁰ p.21 The international taxation system - History of taxation, William D. Sampson

²¹¹ <http://www.hmrc.gov.uk/history/taxhis1.htm> / p.3 Taxation of Electronic commerce, W J Craig

²¹² The international taxation system - History of taxation, William D. Sampson

²¹³ Turning point? The volatile geographies of taxation, Cameron

²¹⁴ Brownlee 2004 'Federal Taxation in America: a short history', 2nd ed, Cambridge, England: Cambridge University Press and Woodrow Wilson Centre Press

²¹⁵ For relevant discussion see Manuel L. Jose and Charles K. Moore, 1998, The development of Taxation in the Bible: Improvements in counting, measurement and computation in the ancient middle east, The Accounting Historians Journal, Vol. 25, No. 2 (December 1998), pp. 63-80. Also, Kim Plofker, 2009, Mathematics in India, Princeton University Press. Also, WN Wan Bakar, 2011, Mathematics in the Holy Quran, Journal of Academic Minds

evidence of tax system at the same time that other areas were being developed, such as mathematics, is the one in Mesopotamia, where historical records dating back to 2500BC indicate payments made by the citizens as a form of taxation towards the main religious leader²¹⁶. These were then used partially to build infrastructure like canals. Solon in Ancient Athens around 590BC saw that prosperity was evident amongst the Athenians and he imposed tax on property, which set the ground and about a hundred and fifty years later, citizens of Ancient Athens had to pay taxes on their land, houses, as well as slaves, furniture and income²¹⁷. By the 12th century, European states, initially Italian and Dutch, had a well-established system of property taxation. Two centuries later in England the property tax under the name of '*the fifteenth and the tenth*'²¹⁸ appeared. It applied both to real estate as well as personal property, which did create a problem. The problem was in regard to tax collection and the personal property, or '*movables*', which were easily hidden from tax collector.

The 14th century England '*the fifteenth and the tenth*' property tax situation does resemble some of the concerns over taxation of electronic commerce; the intangible nature of some goods and services could be a contributing factor to increased anonymity and loss of revenue; it could be easier kept secret from tax collector, just like

²¹⁶ The significance of Ancient Mesopotamia in Accounting History, Garbutt

²¹⁷ The international taxation system - History of taxation, William D. Sampson

²¹⁸ Wareham A, 2012, Fiscal policies and the institution of a tax state in Anglo-Saxon England within a comparative context, The Economic History Review, Volume 65, Issue 3, pages 910–931, August 2012

was the case in 14th century Britain²¹⁹. In 14th century Britain, there were difficulties for the taxman to impose levy on products and items that were easily hidden or he was not aware of. Similarly, the online environment offers the potential for a comparable set of circumstances. Then the items could have been crops hidden anywhere in the house or other places that the taxman would not be able to find them. The internet offers a place to hide aspects of a person's online behaviour and actions. So there are some analogies, from the time taxation was developing to considering taxation of electronic commerce. These similarities can potentially present constructive information, drawn upon from past situations and regulatory frameworks, for the research into taxation of electronic commerce.

So far there has been a general brief overview of taxation and its development through different eras. What about consumption and sales related taxation? In Rome, for instance, there was a tax on sale of slaves, as well as paying a form of import-export tax for value of goods, which at that time was more an issue of payment to the different rulers so that the traders would be protected. It was similar to what nowadays is part of the taxation outcomes; citizens pay taxes to the government, who then has to return services back to them, and these services will include Police amongst others. The Romans' import-export tax was not part of democratically funded governance, but the payment of the said tax was offering some protection to the traders, and at times they

²¹⁹ The History of Parliamentary Taxation in England, Shepard Ashman Morgan, David A. Wells

would have to pay to more than one ruler, depending on the places their route would go through, and unlike today there were no equivalent to a double taxation treaty.

Similar findings have been discovered in relation to Phoenicians²²⁰. In England in the 13th century there was the Channel cross commerce as well as the need for sources to fund the Crusades. These meant the development of consumption taxes, such as the “*fifteenth*”²²¹, which was a tax all traders shipping goods in or out of Britain had to pay to the King. The British also used similar methods of raising capital in America as well. In order to make British goods seem more competitively priced to American consumers, they imposed taxes on high rates on goods imported to the American Colonies from other countries. Similar techniques were later, 19th and early 20th century, used in the U.S. to ensure consumption of local products and to discourage importing²²².

Taxes usually are presented in the form of a charge on certain luxuries as well as necessities. There are taxes on mobile phone bills, petrol and electricity. There are taxes imposed on social activities such as cinema ticket or ticket to attend a sports event. Some activities such as gambling, alcohol, tobacco, have taxation adhered to them as a way to control their social perception and attempt to limit the demand. A good example

²²⁰ Jose M.L. & Moore C.K, 1998, The development of taxation in the Bible; Improvements in counting, Measurement and computation in the Ancient Middle East, Accounting Historians Journal , Vol.25, No 2

²²¹ Samson, W. 2002, History of Taxation in ;Tax System.Lymer A, Hasseldine J 2002 “The International Taxation System”, Kluwer Academic Publishers

²²² The evolution of the U.S. income tax: the history of progressivity and influences from other countries, Samson W.D.

of such tax is the 18th century “tea tax”, under which tea was actually taxed as it landed on American soil²²³ and the trader would have to pay the taxation imposed before being allowed to take his shipment of tea to sell²²⁴. Similar to that, the first national tax in the United States of America was the Whisky Tax in early 1790s²²⁵. The first State imposed sales tax was introduced in the States in the 1930s²²⁶. On the other hand, Value Added Tax (VAT) did initially appear in the 1950s in France, initiated in 1954 by Maurice Laure being Director of Tax Authority in France.²²⁷ However, it was not until the Sixth VAT Directive (in May 1977)²²⁸ that there was an adoption and agreement for uniformity of the VAT coverage from other European Countries.

Alongside the development of taxation regulation, it became evident that tax can also be used for controlling aspects of social life. Examples of such approaches can be seen with tobacco and alcohol. By increased taxation on certain products like the tobacco and alcohol, there is an expectation it will discourage people to take up or continue that type of social behaviour. For instance, regarding smoking there are reports indicating increased tax results in drop in the number of smokers²²⁹ Changing economic or social

²²³ Carlson R, 2004, ‘A brief history of property tax’, *IAAO Conference Proceedings on assessment Administration*.

²²⁴ Basu S., *Global Perspectives of Electronic commerce Taxation Law*, Ashgate, 2007

²²⁵ Steve Simon, 2012, ‘Alexander Hamilton And The Whiskey Tax’, Alcohol and Tobacco Tax and Trade Bureau, Regulations & Rulings Division, http://www.ttb.gov/public_info/special_feature.shtml

²²⁶ William F. Fox, 2002, ‘History and Economic Impact’ University of Tennessee, <http://cber.bus.utk.edu/staff/mnmecon338/foxipt.pdf>

²²⁷ Rouet F, VAT and book policy: impacts & issues, 1999, Council of Europe Publishing, p.9

²²⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:347:0001:0118:en:PDF> (June 2009)

²²⁹ More specifically reports relating to New York (http://www.health.state.ny.us/press/releases/2009/2009_06_04_cigarette_tax_increase_anniversary.htm)

circumstances also do play major role in how governments tax; a factor which illustrates the individuality of every tax system. Different jurisdictions will have taxation frameworks rarely identical to other jurisdictions, and even within the same jurisdiction the tax rules need to be adaptable to changing local circumstances as well as global economic conditions.²³⁰ As it can be seen from this brief historic overview, tax is, or should be, a developing and adaptable mechanism, changing as society changes. Looking back at its development from different perspectives it still provides recognition of the fact that taxation is entangled with national and global incidents and circumstances; changing societies will dictate changes in tax regimes. So tax is adaptable but exactly what are the main principles of it that require and permit adapting, and most importantly what are the main reasons and objectives of it?

4. Why tax?

As we seen from the definitions mentioned above, the role for imposing taxation rests with the government of a country, elected or otherwise in power, or by a department/institution of the government. The main role a government undertakes when in power is to ensure efficient running of the country's affairs. In order for most of these affairs to be dealt with in an efficient manner, certain level of expenditure needs

and the European Union (<http://www.archive.official-documents.co.uk/document/cm41/4177/4177.htm>, Smoking Kills - A White Paper on Tobacco - 1998)

²³⁰ International Business Taxation, Picciotto

to take place; for instance in education, health and welfare. The primary principle behind taxation is the very obvious necessity to raise revenue to allow government to pursue expenditure for the economic requirements of the country. Redistribution of wealth is a generally accepted purpose of taxation, making taxation '*progressive*' and directing some of the revenue collected to welfare service provision.²³¹

In 2012 the tax revenue as percentage of the total GDP, i.e. the sum of taxes and social security contributions showed overall increase in most countries.²³² In the 27 European Union Member States amounted to 40.1 % of GDP²³³. This value is lower in the United States (25.1%) and Japan (27.6% in 2011)²³⁴. For instance in Denmark it amounts to 48.1% while in Romania it is at 27.3%, and in the UK it is at 35.5%.²³⁵ That illustrates the point made above about the significance of taxation and collection of revenue for governments. This revenue provides the funds for necessary governmental expenditure in services for the citizens, such as social security benefits and education as well as on other state affairs such as national defence. Due to its complex nature, taxation not only has economic but many political implications as well. An unpopular tax can be a very

²³¹ Neslihan Uler, 2009, Public goods provision and redistributive taxation, Journal of Public Economics, Volume 93, Issues 3–4, April 2009, Pages 440-453 (<http://www.sciencedirect.com/science/article/pii/S0047272708001357>)

²³² World Bank data, <http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS/countries> (last accessed November 2012)

²³³ Eurostat, Main national accounts tax aggregates, Last update: 29-11-2012
http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en

²³⁴ Total tax revenue as a percentage of GDP, October 2012, http://www.oecd-ilibrary.org/taxation/total-tax-revenue_20758510-table2

²³⁵ Eurostat, Main national accounts tax aggregates, Last update: 29-11-2012
http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en

serious political mistake; taxation authorities may have problems enforcing it, or problems with the resources and mechanisms needed for its collection, while, if there is public outcry, it can also cost a politician the public's vote²³⁶. Taxation is also a form of controlling efficiently the economy and its trends²³⁷. Customs duties provide a good example to indicate this point. For instance, in the 1930s in order to protect the British leather industry a high customs duty was imposed on imported leather²³⁸; in this example the tax was very well designed for its purpose, as it was not meant to collect money but to control a specific element of the market and protect the trade of British leather²³⁹.

4.1 How to tax? Adam Smith and the '4 canons'

The principles for a taxation system can vary from one jurisdiction to the other; with the emphasis being placed on different aspects according to the individual monetary policy and culture. However there are some basic principles that of course do not provide an answer to "*what is the best tax rule*" but they provide the basics for designing an

²³⁶ There is a great degree of literature examining the relationship between taxation and political implications. See Aaron Wildavsky, 1992, "Political Implications of Budget Reform: A Retrospective" *Public Administration Review*, Vol. 52, No. 6 (Nov. - Dec., 1992), pp. 594-599. Also, Collier, P. (2009). The political economy of fragile states and implications for European development policy. Background paper for European Report on Development. <http://erd.eui.eu/media/Collier.pdf>. Also, Charles E. McLure, Jr., 1992. "The Political Economy of Tax Reforms and Their Implications for Interdependence: United States," NBER Chapters, in: The Political Economy of Tax Reform, NBER-EASE Volume 1, pages 97-116, National Bureau of Economic Research, Inc.

²³⁷ Richard M. Bird and Eric M. Zolt. April 2003, Introduction to Tax Policy Design and Development. Practical Issues of Tax Policy in Developing Countries, World Bank, April 28-May 1, 2003

²³⁸ HANSARD 4 June 1934, Commons Sitting - FINANCE BILL, <http://hansard.millbanksystems.com/commons/1934/jun/04/clause-6-customs-duty-on-patent-leather>

²³⁹ The House of Commons - 1690-1715, Cruickshanks E., Hayton D., Handley S., History of Parliament Trust

efficient and better for the taxpayer tax system. Adam Smith, a Scottish economist and customs official, in the end of the 18th century, 1776, produced some very important literature presenting his '*four canons*'²⁴⁰ to try and answer what is the best form of tax and improve taxation regulation. His books were stating his preference for a free market economy as more productive and more beneficial to society²⁴¹. Smith prescribed the four principles which he thought were the substance of an efficient tax system: a) Equity, b) Certainty, c) Convenience and d) Efficiency²⁴².

4.1.1 Equity

The Equity principle refers to the fairness principle that taxation should treat taxpayers with; people should not be asked to pay taxes which are not in proportion with their financial status. '*The subject of every state should contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is in proportion to the revenue which they respectively enjoy under the protection of the*

²⁴⁰ Smith, Adam. 1904, An Inquiry into the Nature and Causes of the Wealth of Nations. Edwin Cannan, ed. 1904. Library of Economics and Liberty. (Retrieved December 6, 2012 from the World Wide Web: <http://www.econlib.org/library/Smith/smWN.html>)

²⁴¹ Raymond De Roover, 1955, Scholastic Economics: Survival and Lasting Influence from the Sixteenth Century to Adam Smith, The Quarterly Journal of Economics, Vol. 69, No. 2 (May, 1955), pp. 161-190.

Also, Sen, A, 2010, Adam Smith and the contemporary world. *Erasmus Journal for Philosophy and Economics*, 3(1), 50-67.

Also, Karen McCreadie 2009, Adam Smith's The Wealth of Nations: A modern-day interpretation of an economic classic: A Modern-day Interpretation of a True Classic, Infinite Ideas

²⁴² An inquiry into the nature and the cause of the Wealth of Nations, Book 5, Chapter 2 – part 2 “of Taxes”, Smith A. (1776)

*State*²⁴³. Adam Smith is considered as one of the advocates of ‘*progressive*’ taxation, however considering the above quote it can also be argued that he was a proponent to ‘*proportional*’ taxation, as he debates the aspects of taxpayer only paying ‘*in proportion to revenue they respectively enjoy*’. Proportionality could be seen as a direct representation of income to taxes, since Adam Smith considered the best measure of a citizen’s well-being and capacity to pay taxes would be mirrored in their income. If a tax is fair, then the impact it will have on the taxpayers will be similar, whether the taxpayer is a millionaire or a worker on minimum wage.

4.1.2 Certainty

Smith also argued that tax regulation should provide certainty. ‘*The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer*’²⁴⁴ Certainty would easily allow the taxpayer to predict the tax they would be charged. If the rules are clear and easily

²⁴³ V 2.25 Book V, Chapter II, Of the Sources of the General or Public Revenue of the Society (<http://www.econlib.org/library/Smith/smWN21.html#B.V,%20Ch.2,%20Of%20the%20Sources%20of%20the%20General%20or%20Public%20Revenue%20of%20the%20Society>)

²⁴⁴ V 2.26 Book V, Chapter II, Of the Sources of the General or Public Revenue of the Society (<http://www.econlib.org/library/Smith/smWN21.html#B.V,%20Ch.2,%20Of%20the%20Sources%20of%20the%20General%20or%20Public%20Revenue%20of%20the%20Society>)

accessible to the taxpayer then the individual taxpayer can assess to an extent the outcome of his economic decisions at the point when made. Adam Smith claims the contrasting scenario would be the '*tax-gatherer*' to accumulate an authority which could potentially endanger any decisions made. This Smith argues could mean corruption is likely to ensue, and a degree of inequality to appear towards the taxpayers thus moving further away from certainty. Especially now with all the available technology, certainty appears to be a realistic aim for an efficient tax system, as information can be available at everyone's disposal, creating a sense of clarity in the demands and obligations towards the taxpayer.

4.1.3 Convenience

If a tax cannot be paid, then governments lose on revenue, and for that reason the way taxes are charged should be done in a way that is more convenient for the taxpayer. *'Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.'*²⁴⁵ Trying to make taxes easier and more convenient for the taxpayer has been a matter of debate and an objective for tax

²⁴⁵ V 2.27, *ibid*

authorities for a number of years²⁴⁶. Making taxes more convenient to the taxpayer means the taxpayer can choose when to pay and how to pay them. For instance in regards to purchasing consumables or general goods, it is the choice of the consumer to buy them and the tax is paid by the consumer too²⁴⁷, but according to Smith the taxpayer chooses when and how much he will pay; purchase big quantity pay more taxes on the goods, purchase less pay less tax. Of the canons mentioned so far, convenience would be closely related in certain aspects of electronic commerce as well as e-governance. E-taxation, including e-filing and e-consulting, relates to the convenience aspect for taxpayers as well as increasing compliance; the information available online in certain jurisdictions can be a tremendous help to someone who is looking for tax forms, tax calculators even different tax regimes applicable to the individual's profit or income.²⁴⁸ If carefully designed, a tax system could meet the convenience canon not just for the taxpayer but for the tax authorities too, as it will make compliance easier and allow for better relationship between taxpayer and tax authority.

²⁴⁶ Bittker, Boris I. 1975, Tax Reform and Tax Simplification, 29 U. Miami L. Rev. 1 (1974-1975) Tax Reform and Tax Simplification. Also, Clinton Alley and Duncan Bentley. (2005) "A remodelling of Adam Smith's tax design principles" Bond University Faculty of Law, E-publications http://epublications.bond.edu.au/law_pubs/45

²⁴⁷ For example VAT already charged on the price of the products at the time of purchasing.

²⁴⁸ Kamarulzaman, Y., & Azmi, A. A. C. 2010, Tax E-filing Adoption in Malaysia: A Conceptual Model. Journal of E-Government, 2010. Also, Chen, C., & Huang, E. 2009, A Study on Taxpayers' Willingness to Use Self-Service Technology-Based Online Government Services. Journal of Electronic Commerce in Organizations (JECO), 7(2), 44-66. doi:10.4018/jeco.2009040103. Also, (Edited by) Maja Klun, Mitja Decman, Tina Jukic, 2011, The Proceedings of the 11th European Conference on eGovernment: ECEG-2011 (University of Ljubljana, Slovenia) , Academic Publishing International Ltd (16-17 Jun 2011). Also, Chatfield, A.T. "Public Service Reform through e-Government: a Case Study of 'e-Tax' in Japan." Electronic Journal of e-Government Volume 7 Issue 2 2009, (pp. 135 - 146), available online at www.ejeg.com

4.1.4 Efficiency

A tax is deemed successful not only when it generates revenue but also when is efficient from every other relevant perspective. *'Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state'*²⁴⁹. If administration to impose and collect the tax is not kept to minimal costs, then the tax system is not efficient. If compliance cost is significantly expensive for the state, then it automatically becomes inefficient for the state and burdensome to the taxpayer. This fourth canon relates to matters of cost, both compliance and administrative costs.

Smith's principles are still in the centre of the debate of how to design a good tax system. A couple more principles can be added to these four; that is a tax system must be flexible and must also be convenient and competitive on an international scale²⁵⁰. As the economic situations change rapidly, not only internationally but even within a

²⁴⁹ V 2.28 Book V, Chapter II, Of the Sources of the General or Public Revenue of the Society (<http://www.econlib.org/library/Smith/smWN21.html#B.V,%20Ch.2,%20Of%20the%20Sources%20of%20the%20General%20or%20Public%20Revenue%20of%20the%20Society>)

²⁵⁰ Picciotto S, 1992, International Business Taxation: A Study in the Internationalization of Business Regulation, Greenwood Press

country's borders, tax system has to provide for a degree of flexibility; it should be able to have the ability to function in changing conditions without the danger of creating problems for the fiscal operations of the country.

Nowadays, the fact every country trades with many others around the globe is factor to be taken into consideration and ensure that the tax system is a competitive one in the international stage. For instance within EU there are many different tax systems but they all have to be compatible with each other and all must ensure compliance with EU regulation. Governments are therefore faced with a challenging task when designing and adjusting taxes, but without them they simply cannot operate financially.

Adam Smith presented his four axioms in an attempt to, at least theoretically, formulate a framework of principles for efficient tax design and therefore effective taxation. The fourth of his principles refers to cost-effectiveness, which can be seen as the more significant one as it relates to the three mentioned so far and is especially relating to enforcing the tax successfully. Efficiency is usually referring to whether the cost of tax collection is too high for the tax authorities, which can be directed to the taxpayers themselves. The compliance cost sometime can be hidden resulting in the actual cost not being depicted exactly in the direct government costs. It also could mean that the taxpayer can potentially incur the extra costs. The PAYE system provides an example of

this, where the employer is acting in the form of an unpaid collector for the Revenue, while another example is a merchant incurring cost in his compliance with the VAT scheme. In both instances significant cost can exist in ensuring compliance with the procedures, in the form of getting professional expertise and advice in relation to the specific tax affairs; cost which could ultimately be passed on to the end consumer.

4.1.5 Examining Efficiency

In order to examine efficiency in a tax²⁵¹, consideration of the effects of taxation may be necessary. Is a tax something working as incentive for a taxpayer or the factor that discourages them? Income tax for example is something directly affecting any working individual; would a higher rate of income tax make people work harder or would it operate as a disincentive? Research shows that higher taxes do act in a negative manner²⁵². According to Smith higher taxes could create an atmosphere of unmotivated taxpayers, and more specifically higher business taxes could lead to price increase²⁵³.

²⁵¹ Clinton Alley and Duncan Bentley. "A remodelling of Adam Smith's tax design principles" 2005
http://epublications.bond.edu.au/law_pubs/45

²⁵² For some discussion on this issue see, Slemrod, J. (1991). Optimal taxation and optimal tax systems (No. w3038). National Bureau of Economic Research. Also, Block, W., & Portillo, J. E. (2012). Negative Effects of US Taxation. *Studies in Economics and Finance*, 29(2), 1-1. Also, Traxler, C. (2010). Social norms and conditional cooperative taxpayers. *European Journal of Political Economy*, 26(1), 89-103.

²⁵³ <http://www.econlib.org/library/Smith/smWN.html>

Also, could lead to increased attempts of tax avoidance or unfortunate incidents of tax evasion, resulting in less revenue collected²⁵⁴.

Tax evasion tends to result in punitive action taken, as it involves criminal behaviour to an extent. But tax avoidance, while not carrying criminal components can sometime be considered as unethical or objectionable, depending how elaborately the taxpayer tried to avoid taxes. It also depends on the type of taxes and that is a reason why tax authorities changed the focus of their attention in the 1970s²⁵⁵. For instance, income tax is easier to avoid than VAT is, and the latter over the last 40 years has become an increasingly important & profitable tax. Better efficiency and less potential of evasion is a positive step forward however has been criticised on the aspect of contradicting the progressive principle²⁵⁶ and favouring those on higher income. The advocates of expenditure tax claim it is more difficult to evade resulting in higher revenues and also the cost of administration relating to expenditure tax is lower²⁵⁷.

The four Smithsonian canons are useful in attempting to create a framework on which to evaluate efficiency. However, Smith first published them in 1776 and now these

²⁵⁴ It is essential to emphasise the distinction between tax avoidance and tax evasion at this point. The first refers to taxpayer attempting to pay as less tax as possible while staying within legal avenues pursuing that. Tax evasion refers to a taxpayer escaping tax by unlawful ways.

²⁵⁵ Tom Clark and Andrew Dilnot' Long-Term Trends in British Taxation and Spending, 2002, <http://www.ifs.org.uk/bns/bn25.pdf>

²⁵⁶ Edwin R. A. Seligman, The Theory of Progressive Taxation, *Political Science Quarterly*, Vol. 8, No. 2 (Jun., 1893), pp. 220-251

²⁵⁷ Cost of collecting Customs and Excise duties is less than the cost of collecting Inland Revenue taxes.

should apply to a wider and more international context. Currently European Union is a significant international player and every Member State plays a role in that as part of the Union. From a different viewpoint, there is tax competition between the Member States creating two levels of interaction; one where there is a tax harmonisation element and the other one where each Member State is adamant on protecting their own tax nature and environment²⁵⁸.

So far, many theoretical approaches on how to judge efficiency of taxation reflect the perspectives of Adam Smith. Another way to examine the effectiveness of a tax is by looking at figures provided by the relevant bodies or research groups in the area. What do the statistics show? Can we identify through them the efficiency of a tax by means of revenue brought in, by means of the tax actually meeting the financial and policy targets it was brought in to tackle? Or the statistics indicate a significant problem with increasing revenue loss?

4.1.5.1 Efficiency in numbers

According to a recent report by the Information Technology & Innovation Foundation (ITIF), a Washington based think tank the annual global economic benefit of the

²⁵⁸ Kirchgässner, G., & Pommerehne, W. W. (1996). Tax harmonization and tax competition in the European Union: Lessons from Switzerland. *Journal of Public Economics*, 60(3), 351-371.(Also, for discussion on the competition between governments regarding consumption taxation see Jacobs, J. P., Ligthart, J. E., & Vrijburg, H. (2010). Consumption tax competition among governments: Evidence from the United States. *International Tax and Public Finance*, 17(3), 271-294.)

commercial Internet for the 2010 equals \$1.5 trillion, more than the global sales of medicine, investment in renewable energy, and government investment in R&D (Research & Development), combined²⁵⁹. That is an indication of how significant the online commerce is for the governments and their revenues. This number has been increasing over the last couple decades to a degree that warranties the tax authorities' attention. More specifically U.S. electronic commerce sales totalled \$165.4 billion in 2010, up 14.8% from \$144.1 billion 2009, according to non-adjusted estimates released today by the U.S. Commerce Department²⁶⁰. For 2011 the total electronic commerce sales were estimated at \$194.3 billion, an increase of 16.1 percentage from 2010²⁶¹. The Census Bureau of the US Department of Commerce reported that the estimate of U.S. retail electronic commerce sales for the third quarter of 2012 was \$57.0 billion, an increase of 3.7 percent from the second quarter of 2012.²⁶² These figures are emphasising the indication of constant growth in the importance and amount of electronic commerce sales for a country's economy.

²⁵⁹ The Internet Economy 25 years after Dotcom, ITIF, 2010, <http://www.itif.org/files/2010-25-years.pdf> (last accessed January 2012)

²⁶⁰ http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

²⁶¹ http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

²⁶² QUARTERLY RETAIL ELECTRONIC COMMERCE SALES 3rd QUARTER 2012 FRIDAY, NOVEMBER 16, 2012, AT 10:00 A.M. EST http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

In the EU on the other hand, business to consumer electronic commerce market is estimated to be around €91 billion in 2010²⁶³. Overall this is representative of only 3.5% of the total EU retail sector²⁶⁴ but it is a figure that indicates electronic commerce is having a significant transformational impact on the retail sector. It should be increasingly one of the main elements of any retailers' business strategies, since it allows significant benefits and especially the availability of a vast market and consumers from all over the globe²⁶⁵.

EU has tried to take a more regulatory approach and imposed regulations from the end of 90s, initially following the OECD Ottawa guidelines and later examining the expanding EU online market²⁶⁶. As specified in the site of the European Union the reason EU wants to regulate electronic commerce profits is not because it is a significant source of revenue, but to address ecommerce in fair and realistic manner. To a question about the 2002 VAT Directive²⁶⁷ and the reason EU is keen to impose VAT on online commercial transactions the response was: *"The level of revenue currently is not an issue. Because this is still a developing area, it is difficult to determine the level of taxable activity and therefore revenue involved. But the Commission has always made it*

²⁶³ Civic Consulting (2011). "Consumer market study on the functioning of electronic commerce". Based on data from Euromonitor covering 24 Member states (excluding Cyprus, Malta and Luxembourg).

²⁶⁴ *ibid*

²⁶⁵ Sun, J. (2012). Studies on Impact of Electronic Commerce to Modern Marketing Environment. Business and Economic Research, 2(1).

²⁶⁶ [http://ec.europa.eu/taxation_customs/taxation/vat/traders/electronic commerce/index_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/traders/electronic%20commerce/index_en.htm)

²⁶⁷ Council Directive 2002/38/EC

*clear that revenue-raising is not the objective of the Directive. What is important is to correct the competitive imbalance and to establish an equitable taxation structure that addresses electronic commerce in a fair and realistic manner.”*²⁶⁸

One of the key objectives of the 2002 Directive was the provision of a level playing field for EU businesses, which makes the idea of not treating the electronic commerce generated tax as significant, an irrational one. Taking that approach EU also indicated that there is nothing revolutionary about electronic commerce from a tax perspective and any tax implication from electronic commerce could be accommodated with minor adjustments of existing regulation.²⁶⁹ This incremental approach can create the sense of conservative treatment of a non-conservative development, therefore lacking and resulting in inadequate management of it. The 2011 Eurobarometer Flash Report showed that across most countries (EU27) surveyed, the Internet was the most common distance sales channel for retailers; for instance 78% of retailers in UK and 58% in Austria said they sold goods or services via the internet.²⁷⁰ Considering only the retailers selling products or services via the Internet 27% estimated that electronic commerce sales accounted for more than 30% of their total turnover and 24% said that this share was between 11% and 30%.²⁷¹ These figures in conjunction with the statistics provided

²⁶⁸ [http://ec.europa.eu/taxation_customs/taxation/vat/traders/electronic commerce/article_1610_en.htm#a11](http://ec.europa.eu/taxation_customs/taxation/vat/traders/electronic%20commerce/article_1610_en.htm#a11)

²⁶⁹ US Treasury Dept Office of Tax Policy, Selected Tax Policy Implications of Global Electronic Commerce (1996) (available at <http://ustreas.gov/offices/tax-policy/library/Internet.pdf>)

²⁷⁰ p.8, http://ec.europa.eu/consumers/strategy/docs/retailers_eurobarometer_2011_en.pdf

²⁷¹ P.14, http://ec.europa.eu/consumers/strategy/docs/retailers_eurobarometer_2011_en.pdf

above as well as other relevant research, such as the Report by J.P. Morgan senior analyst, Imran Kahn, show that electronic commerce is constantly developing into a greater revenue potential for governments. J.P. Morgan expects electronic commerce revenue will grow to USD 680 billion worldwide by the end of 2011, up 18.9 percent compared to 2010. They also predict that the global electronic commerce market is likely to grow at an average rate of 19.4% between 2010 and 2013, with electronic commerce revenue hitting USD 963 billion by 2013.

The e-VAT Directive²⁷² was seen as the initial attempt by EU to attempt and regulate electronic commerce and its tax implications. It has been seen as ineffective due to its conservative approach and the debate suggests it has also been ineffective in collecting the revenue.²⁷³ The e-VAT allowed for different tax treatment depending on the company's location, therefore creating the opportunity for companies to relocate to less taxing jurisdictions. In the subsequent attempts to reconsider and adjust the Directive²⁷⁴, the approach became more focused and technological developments made EU to consider a more efficient and clear approach; for instance changing the place of taxation to destination/consumption rather than place of supply as was originally²⁷⁵. In 2006 a proposal issued by the EU suggested the need for monitoring of the objectives

²⁷² Council Directive 2002/38/EC

²⁷³ Oleksandr Pastukhov, (2007) The e-VAT Directive: Mitigating Tax Competition or Spurring it?, 2 J. Int'L & Tech. 54, 55-56 (2007) (available at <http://www.juclt.com/index.php/jiclt/article/viewDownloadInterstitial/18/18>)

²⁷⁴ http://ec.europa.eu/taxation_customs/taxation/vat/traders/electronic_commerce/index_en.htm

²⁷⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0001:0006:EN:PDF>

and outcomes of the Directive as well as the need for some amendments.²⁷⁶ This is perhaps an indication that amendments were necessary to ensure efficiency in its functionality, especially since in 2000 the Internet did not have the considerably larger coverage it had 6 years afterwards. The efficiency will not be 100% accurate, especially when considering regulation on such a changeable and multi-dimensional area.

Policy-makers and tax authorities want to ensure the minimal loss of tax revenue relating to electronic commerce; therefore there have been consultations and proposals put forward to close the gap between law and technology, especially when regulation has evolved slowly in comparison²⁷⁷. A consultation to examine the current status and the future of the VAT system generally, as well as in specific sectors as electronic commerce, is the Consultation on the 'Green Paper on the future of VAT– Towards a simpler, more robust and efficient VAT system'²⁷⁸. The Green Paper takes a positive approach and recognises that as far as VAT efficiency is concerned technological advances offer the possibility of new and alternative ways of collecting VAT to reduce burdens on business and VAT losses. From theoretical approaches to examine tax efficiency to simply considering the figures indicating how much revenue electronic commerce is creating, it is evident that electronic commerce offers a great revenue

²⁷⁶ http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/com%282006%29210_en.pdf

²⁷⁷ For instance, the existing VAT collection model has remained substantially unchanged since the introduction of VAT.

²⁷⁸ http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_11_future_vat_en.htm

generating source and its taxation needs to be carefully designed so that it operates efficiently. The answer to the question “tax or no tax” for electronic commerce is definitely a yes, in order not to impair the governments’ ability to improve education, health, roads, public safety, creating dedicated local and state revenue source for youth programs, and many other essential services.²⁷⁹

5. Direct and Indirect taxation

Taxation has mostly been a reactionary process, especially as an international dimension. The development of electronic commerce is not the only matter causing problems to taxation conventions. Looking at matters arising out of the functions of international taxation it is evident the systems that were in place did not appear fully capable to consolidate or even coordinate the variety of tax models, thus raising the disparity to an existing problem²⁸⁰. That matter becomes potentially exaggerated within the arena of electronic commerce. Currently more than 1500 bilateral double taxation treaties are in application, many of which are not in line with the OECD conventions²⁸¹ and that causes significant pressure to commerce as well as on taxation authorities,

²⁷⁹ Omar, Kwun & Bhutta, (2008) The Impact of Electronic commerce tax policy on State and Local Government Revenue,, <http://www.swdsi.org/swdsi08/paper/SWDSI%20Proceedings%20Paper%20S150.pdf>

²⁸⁰ Jinyan Li (2003) ,International Taxation in the age of electronic commerce: a comparative study, Canadian Tax Foundation

²⁸¹ Owens J (1998), Taxation within a context of economic globalisation, (Bulletin for International Fiscal Documentation)

considering that commercial transactions spread out even beyond borders and there is an increasing amount of trade occurring on a transnational scale. The basis of the double taxation treaties is on the assumption that tax policy exists within national confines, something that, because of globalization and technological advances, becomes outdated as time goes by for conventional types of commercial transactions and of course for online commercial transactions. Bird presenting his ideas on allocation of fair shares of taxation to different jurisdictions, said “yes, but what fair share is and, even more basically, what the profits that are subject to tax are?”²⁸² This could be discussed more detailed in relation to the taxation principles from the OECD Framework, namely neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and finally flexibility. So what needs to be considered more adequately is what needs to be taxed, and who should tax; what types of taxes can be identified with one or other type of function to achieve an established taxation model.

*“Tax is often regarded as being about numbers. Tax law is about words. It is an odd thing that many lawyers and legal academics seem worried about studying tax, because they are worried about numbers”*²⁸³. The truth is actually that tax law is more concerned with the aspects of interpreting and applying laws that relate to taxation. Looking at taxation from a wider perspective than simply the national perspective, there is the

²⁸² Bird R (2003) Taxing electronic commerce: a revolution in the making. C.D. Howe Institute Commentary, No 187 September 2013

²⁸³ Morse G. & Williams D.(2005) Davies: Principles of tax law, Sweet & Maxwell, 5th ed. P21,

need to investigate through a multi-jurisdictional prism. Most of them with varying tax systems and processes; each nation has its own regulation in place and part of tax law is to attempt to comprehend and interpret aspects of these systems in order for some common ground to be found. Double taxation treaties have been put in place to face that challenge, to an extent. As mentioned above, there are concerns in regard to these treaties; there are questions regarding their functionality and adjustability. However there are two distinct categories to assist in identifying and subsequently regulating these taxes; direct and indirect tax systems.

Sometimes citizens may not have a complete and accurate understanding of where and how directly taxes go government. They are not always able to indicate precisely what taxes go directly to their government and what is the process; there is a plethora of taxes levied, which makes it more difficult. A rather common direct tax is income tax, a tax directly charged on the individual receiving the income. Another one is corporation tax, which is of similar functionality to the income tax but it is generated from corporations. Income taxation is a significant form of revenue for countries; in all OECD countries income tax is almost one third of all tax-generated income for governments²⁸⁴. Internal taxes, within a specific jurisdiction, do provide certain aspects requiring the attention of tax authorities. However it is not only taxes within a jurisdiction that need

²⁸⁴ Peters, B. G. (1991). The politics of taxation (pp. 29-35). Cambridge: Blackwell.

attention and further research. Taxes on an international spectrum can also be a matter raising significant and challenging matters.

International taxation presents challenges because of its complexity and subjectiveness. Lack of international consensus on the tax base is the main reason for creating a situation of uncertainty and complexity. Currently the trade climate is of an international character, but at the same time governments consider tax as a local aspect of their regulating, resulting in a climate of uncoordinated tax regimes. Despite the localized perspective of many tax jurisdictions, examples of widely applicable rules are not uncommon; these rules were developed from common thoughts on economic cooperation between developed countries. For example, these rules are identifying concepts like source-based and residence based taxation in regards to taxing income.

Another common occurrence amongst different jurisdictions is the concept of Permanent Establishment, which is examined later in the chapter, when attempting to assign economic nexus for a specific jurisdiction. The functionality of double taxation treaties, creating effective models for implementing tax systems, and investigating the tax treaties in order to assess the better understanding and achieve a non-problematic

harmonized policy on taxation amongst systems are some of the avenues which can help international taxation achieve a common ground²⁸⁵.

As Kobrin says, states operate their tax systems on fiscal sovereignty, which is “...territorially-based economic governance is vectorial in that it assumes that all events, transactions and business entities can be located unambiguously in terms of fixed two dimensional geographic coordinates. It assumes that regardless of how international the world economy might be, one can determine where a transaction takes place and thus whose law, regulation or taxation applies”²⁸⁶ Development of tax systems started when transactions were mainly within state borders, from the times of Ancient Egypt to the first adequately regulated & sustainable tax system in Persian Empire. Therefore the majority of rules were designated to deal with issues existing from trade within domestic national boundaries. It is evident from some academic debate that the emergence of globalization brought worries to governments; competitiveness, tax evasion and avoidance, competition and the international aspect of tax revenues²⁸⁷.

The idea of a jurisdiction having sovereignty within a state’s borders is a “dense ideological smokescreen”²⁸⁸, and that is where international taxation attempts to face

²⁸⁵ , Zee (1998) Taxation of Financial Capital in a globalised environment; the role of withholding taxes (National Tax Journal, Vol.51-3)

²⁸⁶ Kobrin (2001) Territoriality and Governance of Cyberspace, (Journal of International Business Studies, Vol.32)

²⁸⁷ Basu, S. (2007). Global perspectives on e-commerce taxation law. Ashgate Publishing, Ltd..

²⁸⁸ Cameron, A. (2006). Turning point? The volatile geographies of taxation. Antipode, 38(2), 236-258.

challenges presented from individuals and companies conducting businesses internationally and not only within one state. The two mainly predominant theories having an impact on the literature relating to a country's right to taxation are described by Pinto as follows, "Under the benefit theory, a jurisdiction's right to tax rests on the totality of the benefits and state services provided to taxpayers that interact with a country. Under the sacrifice theory, taxes are viewed as a sacrifice owed to a country due to the higher moral value of community purposes over individual aims"²⁸⁹. Today, the sacrifice theory would not be easily accepted by citizens; however the benefit theory seems more in line with many contemporary tax systems and it seems more likely to be accepted by the tax-payers.

Examining the basics of international taxation cannot be done without looking at the two primary bases for tax jurisdiction relating to income tax; on one hand there is an entitlement to the country of residence of the income, and the on the other hand, an entitlement to the country of the source of income. Direct taxation can become complicated when certain jurisdictions pick one or the other, while some others adopt a combination of the two. A source-based tax system gives the right to governments to tax income earned within the borders of its jurisdiction. It also allows governments to take advantage of any income generated within its borders. From the two theories mentioned before, benefit and sacrifice theories, source-based taxation agrees with the

²⁸⁹ Pinto, D. (2003). E-Commerce and source-based income taxation (Vol. 6). IBFD.,

concept of imposing taxes on citizens who will subsequently receive some benefits in return. Moving on to the other side, taxation based on residence is founded on the benefit principle too, so the taxpayer should be taxed where he is enjoying his benefits from state, for example health, education, and infrastructure²⁹⁰. Residence-based taxation means that a country claims a right to impose taxation on the income of its residents, not only within the country's confines but globally²⁹¹. In terms of a company what that means if the company is registered in the UK, if its place of central management is in the UK, then that company will be taxed for the income it is generating, even if part of the income arises from overseas or international commercial transactions.

There are arguments in favour of clearly establishing the place of incorporation or registration of a company for residence purposes, as it creates some certainty. On the other hand, it has been described as arbitrary and artificial²⁹², and the latter was also the view of the OECD Convention²⁹³. A valid test is considered the test of place of central management and control; company's main offices are to be found, where the Directors meet, the "heart" of the company. The second test is more practical than the first one, in terms considering where the offices of a company are physically placed; if they are at

²⁹⁰ Westberg (2002) Cross-border taxation of electronic commerce, 154 (Int'l Bureau of Fiscal Documentation 2002)

²⁹¹ The OECD Model Convention, Art. 10-13

²⁹² A new three-tier proposal for determining corporate residence based principally on individual residence, Pinto (2005)

²⁹³ OECD Model Convention, Art.4 Commentary

one specific location that cannot simply change overnight. There are cases where dual residency may be the issue in question; in such situations OECD Model Convention tries to identify the place of effective management²⁹⁴; what that means is the place where the major decision will be taken by the Board of Directors. Residence-based taxation seems to be a rather considerable option; it will not provoke antagonistic tax competition and it can assist to promote a climate of tax harmonization, as well as set the basis for economic efficiency via taxation. However it can be seen as too idealistic. Countries will not be as keen as to drop their claims to levy non-citizens conducting their business within their borders, and for developing countries residence-based system of taxation could mean much reduced revenues, as their economies are basically operating with a source-based tax approach. Another concern regarding residence-based taxation is that it could promote utilization of tax havens. The source and residency elements are both vulnerable to exploitation, and as mentioned before it is a common occurrence that countries will have taxation rules using both principles.

6. Permanent Establishment

Another important aspect relating to direct taxation is the concept of Permanent Establishment. A non-citizen company will be taxable in a country only if the company

²⁹⁴ OECD Model Convention, Art.4(3)

has PE there²⁹⁵, which indicates what the purpose of PE is; it specifies when a citizen of another country can be taxed in a second jurisdiction. PE is a term that caused a lot of discussion about its precise definition and most of taxation treaties will include a definition, but the proposal of OECD seems to be the widely accepted one as is evident from the language in most income tax treaties²⁹⁶. So, PE usually is “a fixed place of business through which the business of an enterprise is wholly or partly carried on”²⁹⁷. That definition can be analyzed as containing 3 main provisions, which give rise to three tests to help identify them. The place-of-business test has to be sufficed; there should be evidence of actual existence, i.e. equipment, offices. The performance test has to be satisfied, by proof of the establishment to have a “fixed” character, permanence in the area in question. Also the business-activities test follows on and what it means is that the company has to indicate a degree of carrying the business where the “fixed” place is²⁹⁸. These 3 elements of the test have to be met before PE is established.

There have been attempts following OECD initiatives by other bodies to produce a definition of PE. An example of that can be seen from the following quote by the United States Model Income Tax Convention “A general principle to be observed in determining

²⁹⁵ Model Tax Convention on Income and on Capital, OECD (2003)

²⁹⁶ See i.e. the US/UK Treaty Article 5 (almost similar to the OECD Model Article 5. Nigeria/South Africa Treaty Article 5 (nearly similar with an additional provision)

²⁹⁷ OECD Model Tax Convention, Art. 5(1)

²⁹⁸ OECD Model Tax Convention, Art. 5(1)

whether a permanent establishment exists is that the place of business must be fixed in the sense that a particular building or physical location is used by the enterprise for the conduct of its business, and that it must be foreseeable that the enterprise's use of this building or other physical location will be more than temporary"²⁹⁹. Another example is the United Nations Model Tax Treaty that tried to broaden the inclusivity of PE's definition, in order to protect some interests of the developing nations. PE does seem as a very significant rule, and there is enough literature to prove so, but is it a rule that can be justified? The arguments tend to go both ways with some analysts arguing that benefit theory and aspects such as PE are only used to justify certain tax policies while on the other hand, the argument is concerning the arbitrariness of any such justifications³⁰⁰.

Evaluating PE, there is an argument to be made about its efficiency as it does allow a relatively uncomplicated set of rules to companies as well as tax authorities. Also, there have been attempts to alter PE due to technological and political developments and that brought in light an important feature; flexibility. It appears to be an attribute of the principle, allowing it to acclimatize and adjust to varying commercial influences. The flexibility attribute is one making PE rather versatile and also follows on from the OECD principles for taxation, one of the five being flexibility; "The systems for the taxation

²⁹⁹ U.S. Model Income tax convention, Technical Explanation – paragraph 69

³⁰⁰ Cockfield (2004) Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test, Vol 33 No7 Tax Notes International

should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.³⁰¹ So PE being flexible ensures the tax system will be more adaptable to changing socioeconomic circumstances and potential advancements in technology.

7. Consumption taxation

The two main models of indirect tax are the US sales tax or the EU VAT. In contrast to a direct tax, like income tax, the name indirect is justified on the basis that the customer is not directly experiencing a detriment or a benefit. VAT is charged on items before the stage that consumer purchases them, and it is a tax not taking into consideration the tax payer's status. Income tax is levied depending on a person's income, it varies. In contrast, VAT is levied on products before they go for sale, and it is irrelevant whether a wealthy or a person with less financial means will purchase them. Another difference is that with indirect taxes, the consumer, who bears the levy on the product, does not directly pay the tax to the government. VAT and sales tax are two taxes that are strictly consumption-based.

³⁰¹ OECD (1998) "Electronic Commerce: Taxation Framework Conditions" (A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference "A Borderless World: Realising the Potential of Electronic Commerce" on 8 October 1998)

Literature regarding consumption taxes can be traced a few centuries back, when Thomas Hobbes produced his argument that state provided for the citizens protection and services to enjoy life and the taxes are merely the price for that enjoyment and protection³⁰². Some analysts have argued that consumption taxes tend to be more stable and dependable than income taxes. The idea behind it is that the consumption base is less vulnerable than the income tax base; consumption expenditure tends to be more stable than income therefore it provides a more steady source of revenue³⁰³. Also the debate has actually suggested a move from income taxation to consumption; reasons being mainly that consumption taxes are simpler, more efficient and appear fairer for the citizens and the tax authorities³⁰⁴. It is more efficient because there is no distinction between consumption now and in the future, and it has similar ability in relation to redistribution, as well as administration is made easier by not attempting to tax capital, thus avoiding some of the complications involved with that.

Tax authorities can manage and collect indirect taxes with considerably less hassle than a direct tax. The number of taxpayers is smaller and also companies have to satisfy some requirements for registration, and thus compliance is made easier. Is consumption tax actually fairer than income taxes? Tax equity needs to be considered, and that can be

³⁰² Metcalf G. (1999) Consumption taxation: The encyclopaedia of taxation and tax policy, [Hobbes T. "Leviathan" 1651]

³⁰³ Doernberg & Hinnekens (1999) Electronic Commerce and international taxation, international Fiscal Association. Kluwer Law International

³⁰⁴ Bankman J. & Weisbach D. (2005) The superiority of an ideal consumption tax over an ideal income tax, 58 Stanford Law Review 1413

achieved by examining two separate principles; the benefit principle and the ability-to-pay principle.

Benefit principle advocates that fairness should be looked at from the perspective of creating a proportionate stage of taxes levied and services provided to taxpayers for that levy. The benefit principle has a significantly wider viewpoint on tax equity as it implies the need for state's redistribution and welfare policies in the tax equation. The ability-to-pay principle is more focused to the actuality of the ability to pay taxes. Both approaches have shortcomings and that is quite evident from the opinions of Musgrave and Musgrave, who said "...neither approach is easy to interpret or implement. For the benefit principle to be operational, expenditure benefits for particular taxpayers must be known. For ability-to-pay approach to be applicable, we must know just how this ability is to be measured. These are formidable difficulties and neither approach wins on practicality grounds"³⁰⁵.

8. Origin and Destination principles

This chapter examined some taxation principles and their significance, as consumption taxation is associated with the destination and origin principles. They are what their

³⁰⁵ Musgrave R.A. & Musgrave P.B. (1973)Public finance in theory and practice, McGraw-Hill Book Company

name specifies; under destination principle the tax is imposed at the place of consumption, whereas origin principle levies the charge at the place of production. Destination principle is viewed as a more fair distribution of the tax burden because the private consumption base is considered more substantial and correct depiction of taxation base. Origin principle says that tax is levied at the point where goods are produced and it carries the implication that prices including tax should be equated across countries. Under origin principle companies will see to locate in a low-tax jurisdiction, thus creating a concern for the number of companies relocating for economic reasons and therefore higher-taxed jurisdictions losing significant revenue. That is what OECD chose to describe as “harmful tax competition”³⁰⁶. Destination principle advocates the opposite; tax is levied at the place of the consumption. Because of that, it would be extremely difficult to collect consumption tax from the consumers, and for that reason the sellers do perform the role of collectors for the taxes. This is a point that causes some problems. By using the sellers as collectors of the taxes it causes a great administrative burden, especially on smaller companies, that makes the compliance cost on the whole a very costly process, both in terms of money and time³⁰⁷. For a company to comply fully and be able to calculate tax for every different jurisdiction they will need very good software, as well as putting a lot of effort in trying to keep up-to-date with different and changing tax rates and other requirements from

³⁰⁶ Harmful tax competition; an emerging global issue, OECD (1998)

³⁰⁷ Masters of complexity and bearers of great burden; the sales tax system and compliance costs for multistate retailers, Cline R. & Neubig T. (1999)

whichever jurisdiction the consumer is from. This requirement could appear burdensome but it does represent a fair burden for a very valuable benefit. Another important thing to mention is that destination principle requires very good intergovernmental cooperation, in terms of common tax policies and initiatives. Destination principle is the system most favorable currently; OECD, WTO and the EU are supporting the principle mainly due to efficiency standards it can attain.

9. Conclusion

This chapter examined aspects relating to taxation. The historic overview was in order to indicate the development and the reality of change or adjustment to taxation systems due to changes in social or political aspects. The question “why tax” tried to give an indication of the need of a society for taxation. The main reason is the need of a state to raise revenue which is then used for welfare state or development within the jurisdiction.³⁰⁸ Adam Smith’s 4 canons are very important to the theory of taxation, as it creates a very specific framework for the creation and operation of taxes, and it applies not only to VAT, the tax directly related to B2C electronic commerce transactions, but can also be used as guidelines for any other type of taxation. The main purpose of the chapter has been to lay the basis on which to build the element of the interaction between tax and electronic commerce. By illustrating the necessary elements and

³⁰⁸ Neslihan Uler, (2009), Public goods provision and redistributive taxation, Journal of Public Economics, Volume 93, Issues 3–4, April 2009, Pages 440-453 (<http://www.sciencedirect.com/science/article/pii/S0047272708001357>)

characteristics a tax should have, it will be easier to try and bring together the traditional element of taxation, which was mainly for specific jurisdiction with boundaries, and see how it can be efficiently brought together with electronic commerce, the online vendor and the consumer.

4. Reacting to the challenges electronic commerce taxing; “soft law” and the US

Contents

4. Reacting to the challenges of electronic commerce taxing; “soft law” and the US.....	147
1. Introduction	151
2. Soft Law	152
2.1 WTO	153
2.2 OECD	155
2.3 1998 Ottawa Taxation Framework	157
2.4 OECD and tax collection	169
2.5 2006 VAT Guidelines	172
3. The approach in the US.....	174
3.1 US case law.....	179
3.2 Clinton Administration	180
3.3 Internet Tax Freedom Act	182
3.4 Streamline Sales Tax Project and Streamlined Sales and Use Tax Agreement.....	188
3.5 Marketplace Fairness Act.....	192
4. Conclusion	194

This Chapter will examine the initiatives promoted by the Organisation for Economic Co-operation and Development and the approach of the World Trade Organisation towards the matter of taxing electronic commerce and more specifically towards consumption taxes, such as VAT or Sales Tax. Special examination will be allocated to the 1998 Ottawa Framework, as in many ways it paved the way on which most of the jurisdictions have built their policies upon. Then the discussion will attempt a careful consideration of the taxation regime in the United States, as far as they are related to online commercial activities. It will produce some useful analysis and help to ascertain whether the two big actors in this area, EU and US, are facing the challenges and considering the way forward in a similar manner or with distinctly different approaches. The Clinton Administration played a significant role in the relevant regulatory framework in the US, when the structural issue of the American tax regime was studied in relation to the rise of online commerce. Also, this chapter will look into the Internet Tax Freedom Act a very important piece of legislation targeting the area of online transactions and internet within the US but also carrying some international implications. In the US there have been interesting developments, such as the Streamlined Sales Tax Project, an initiative which has begun in 2000 to simplify and harmonise tax regime across the 50 States and subsequently became the Streamlined Sales and Use Tax Agreement in 2005. Initiatives such as the aforementioned could be promoting a way towards a further homogenous

system where an attempt for across jurisdictions harmonisation could be less problematic and more efficient.

1. Introduction

The significance of electronic commerce and its relevance to taxation has forced governments and other organisations to react to the challenges presented. Historically the study of tax regulation was mainly focused within the national boundaries and trying to identify the concerns within. Global nature of commercial transactions brought the need for a wider examination of taxation. Due to the nature of the debate, the national perspectives are predominant, even when there is need for an international outlook. The global and evolving nature of internet has contributed in creating the notion of international outlook and the need of multijurisdictional perspective on economic, legal and policy decisions. On one side there is the argument that the cooperation across borders is needed, considering taxation impacts on many aspects of everyday life for

different people across different countries. On the other hand, as Tanzi says, that may not be what is really significant, as he argues global trade agreements can still be operational without the establishment of a universal tax system.

2. Soft Law

Electronic Commerce and its ramifications have been at the centre of debate for many organisations and institutions such as WTO and OECD over the last decades. These participants to the electronic commerce debate have been producing significant and very useful guidance or indications of the developments and they have both been assuming the informal role of supervising attempts to regulate on the Internet and especially for matters regarding taxation³⁰⁹, as the lack of boundaries means one jurisdiction's regulatory framework could interfere in another jurisdiction's online territory. Both OECD and the WTO have been considered as the informal supervisory bodies due to the fact initially countries were unwilling to act and took a "wait and see" approach.³¹⁰

³⁰⁹ OECD Communication on Fiscal Affairs, Electronic commerce: A discussion Paper on Taxation Issues (1998); WTO Ministerial Declaration of 20th May 1998, WT/MIN (98)/DEC/2

³¹⁰ An example of this approach is the ITFA, which will be discussed later in the chapter.

2.1 WTO

The first of the major contributors to this debate is the World Trade Organisation, due to its role assisting the regulation of global trade trends and policies. The WTO has been very active in studying the issue of electronic commerce regulation,³¹¹ and plans to play a central role in global electronic commerce regulation³¹². A March, 1998 WTO report cited the following as key issues deserving 'further consideration':³¹³ (1) the establishment of global telecommunications infrastructure standards, (2) a predictable legal and regulatory structure for enforcing legal rights, (3) content regulation laws, and (4) a predictable framework for taxation and financial regulation.

³¹¹ See World Trade Organization, Study From WTO Secretariat Highlights Potential Trade Gains from Electronic Commerce, March 13, 1999 (commenting on a WTO Secretariat study highlighting the growing significance of electronic commerce). See, e.g., Intl Trade Rep. (BNA), supra note 14. In addition to the WTO electronic commerce report cited herein, the WTO convened a 'draft work program' in July, 1998 on electronic commerce. Six subordinate bodies will report back to the General Council by the end of June, 1999, in time to issue recommendations for member action during the third WTO ministerial to take place at the end of 1999. See generally Information Technology: WTO Council Chair Puts Forth Draft Work Program for Electronic Commerce, 15 Intl Trade Rep. (BNA) No. 29, at 1307 (July 29, 1998).

³¹² See Winston J. Maxwell and Thomas P. Newman, Electronic Commerce Considered By World Trade Organization: Comprehensive Regulatory Review Begun, N.Y. L.J., November 16, 1998 at S7. Because of the multidimensional nature of electronic commerce, the WTO expects to play a central role in its regulation and become the "pre-eminent body" in the international regulation of electronic commerce. Furthermore, the WTO expects a "wide scope of competence" for its role in regulating electronic commerce, expecting electronic commerce issues to touch not only upon traditional GATT (General Agreement on Tariffs and Trade) and GATS (General Agreement on Trade in Services) areas, but also multilateral agreements² especially those touching upon intellectual property, telecommunications, and government procurement. Id

³¹³ See 15 Intl Trade Rep. (BNA) No. 29, supra note 61, at 1307

The WTO acknowledges that because taxation of electronic commerce will be one of the most delicate areas for negotiations (because of multi-jurisdiction and other issues)³¹⁴, further research needs to be conducted in the areas of double taxation, tax jurisdiction, and currently proposed taxing schemes such as the bit tax³¹⁵ and VAT tax.³¹⁵ In keeping with its role as overseer and arbiter of international trade, the WTO is particularly concerned with electronic commerce's impact on developing countries. Developing countries fear that their overall bargaining power with respect to trade may diminish, as developed countries further develop their electronic commerce capabilities thus leading to an even greater disparity between the haves and have-nots. Developing countries also worry that electronic commerce will cause them to be more consumers rather than producers, further exacerbating current balance of payment problems with their wealthier counterparts³¹⁶. From a taxation standpoint, then, developing countries would rather see an electronic commerce taxing regime that favours the collection of taxes from the consumer rather than seller. Developing countries would consequently see less erosion of their tax bases under such a tax regime.³¹⁷ With the other electronic commerce issues, however, the WTO appears currently to be taking a detached posture, only suggesting areas of concern for further consideration and study, waiting for

³¹⁴ See Information Technology: WTO Report Charts Electronic commerce Issues, Sees Key Role For Government Regulators, 15 Int'l Trade Rep. (BNA) No. 12, at 526 (March 25, 1998).

³¹⁵ Arvind Panagariya, Electronic commerce, WTO and Developing Countries, 2000, Policy Issues in International Trade and commodities; Study Series 2, UN

³¹⁶ Department of the Treasury, Selected Tax Implications of Global Electronic Commerce, 18, (1996)

³¹⁷ John K. Sweet, Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles, 146 U. Pa. L. Rev. 1949, 1996-97 (1998). Charles M. McLure, Jr., U.S. Tax Laws and Capital Flight from Latin America, 20 U. Miami Inter-Am. L. Rev. 321, 321, 356 (1989)

member countries to develop their own policy responses before taking any firm positions of its own.³¹⁸

2.2 OECD

One of the first, and very significant, reactions to the potential challenges of taxing electronic commerce was by the Organisation of Economic Co-Operation and Development. The Organisation for Economic Co-operation and Development consists of 34 member countries taking part in a forum debating and developing economic and social. There is no body established specifically to coordinate international electronic commerce taxation, and the OECD has assumed this role over the last couple decades, as online commercial transactions have been forcing countries to create and develop relevant frameworks³¹⁹. The OECD operates as a discussion forum allowing the members states to share their best practices, and attempt to find solutions either unique to them or a solution to assist non-members. That could mean agreeing to take measures by means of establishing legal frameworks or propose a code of practice.

³¹⁸ See 5

³¹⁹ Hellerstein Walter, Electronic Commerce and the Challenge for Tax Administration, 2002, Seminar on Revenue Implications of Electronic commerce on Development, Committee on Trade and Development, WTO, Geneva

The OECD is also known for non-binding instruments on difficult issues such as its Guidelines for multinational enterprises, which are meant to provide common ground and coordination between two neighbouring countries, or two countries trading with one another³²⁰. This can be seen as particularly useful in case of taxation, where cooperation is likely to provide a more efficient structure for tax administration and collection. Overall, OECD can be seen as a group of countries working together towards a commitment to economic development and democratic stability. The main core of the original members include European and North American countries, as well as Japan, Australia, New Zealand, Mexico and four former communist states in Europe: the Czech Republic, Hungary, Poland and the Slovak Republic³²¹. Recently OECD has been focusing its attention to developing markets in order to attract more signatories, and that focus can be justified on the fact developing markets could offer plethora of opportunities for research and evaluation of new practices and possibilities. The way the founding members are connected with each other as well as with the signatories is by treaties designed to express common ground or common aims to reach for in relation to OECD is also a reliable provider of political, economic and social.

³²⁰ <http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/>

³²¹ <http://www.oecd.org/general/listofocdmembercountries-ratificationoftheconventionontheoecd.htm>

The OECD has been on the forefront of addressing the challenges of electronic commerce for the tax systems. As part of their above described role it has issued a couple of guidelines of how to approach the challenges for tax systems caused by electronic commerce and which systems should be applied on an international level. A very important guideline was the report on Taxation Framework Conditions of October 1998³²². It appears that the OECD initially accepted the responsibility to coordinate and enable discussions internationally; an international director of the electronic commerce debate. This role was made formal in a significant ministerial conference in Ottawa in 1998.

2.3 1998 Ottawa Taxation Framework

On the 8th October at the Ministerial Conference in Ottawa the Taxation Framework Conditions Report was presented³²³. This report examined the technologies underlying electronic commerce and their significance and nature. The report suggested that the related technologies may be presenting some challenges, but on the other hand, they also create opportunities. Tax authorities can utilize these opportunities, which could help provide a better service to the taxpayer, and the relevant authorities can operate

³²² OECD, Electronic Commerce Taxation Framework Conditions, 1998, <http://www.oecd.org/tax/consumptiontax/1923256.pdf>

³²³ OECD, Electronic Commerce Taxation Framework Conditions, 1998, A report by the Committee on Fiscal Affairs of the OECD.

on the basis of a more structured framework of the 5 taxation principles, neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility. The Report gives a brief description of each of the five principles:

“Neutrality

(i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency

(ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimized as far as possible.

Certainty and simplicity

(iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

Effectiveness and Fairness

(iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counter-acting measures proportionate to the risks involved.

Flexibility

(v) The systems for the taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.”³²⁴

Another one of the important findings of the Report is directed towards the governmental regulatory bodies advising that the principles, legislative and administrative, used in traditional commercial transactions, should be the ones used in relation to electronic commerce too, ensuring that there is no obstacle in new measures or alterations of the existing ones..³²⁵

Two more recommendations presented in the 1988 Report are specifically in relation to consumption taxes.

³²⁴ OECD (1998) “Electronic Commerce: Taxation Framework Conditions” (A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference “A Borderless World: Realising the Potential of Electronic Commerce” on 8 October 1998), Box 2, p.4

³²⁵ OECD, „Electronic Commerce: Taxation Framework Conditions“ A Report by the Committee of Fiscal Affairs as presented to Ministers at the OECD Ministerial Conference, “A Borderless World: Realising the Potential of Electronic Commerce” on 8th of October 1998, www.oecd.org

OECD recommended that *“rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction”*³²⁶. The place of consumption is recommended as the one that entitles to taxation. Secondly, *“for the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods”*³²⁷. This statement advocated that supply of digitised products, direct electronic commerce transactions, should be considered as supply of services. This distinction did create a different approach to the one adopted at that time by most jurisdictions, where digital goods would not automatically be characterised as services. It also suggests that it supports the idea of consumption taxes imposed at the place of consumption, where the consumer of goods or services will be located³²⁸.

These recommendations were adopted by most of the country-members within the following years after the Ottawa Ministerial conference. One issue that arose and attracted criticism after the 1998 proposals was the lack of accurate definition or specific characteristics of the place of consumption; neither did it provide a clear and widely compatible definition of services. These two definitions were left out of the 1998

³²⁶ *ibid*

³²⁷ *ibid*

³²⁸ Craig W, Taxation of Electronic commerce, 2001, 2nd ed, Tolley

report, and the reason could be OECD wanted to set the basis of the proposed framework initially, and later re-examine the framework so as to clarify and develop it further. This can be seen in the 2003 Report, which reads “since 1998 the work of the OECD’s Committee on Fiscal Affairs has continued to develop these principles [the 1998 taxation conditions] into practical guidance for international application”³²⁹.

The Working Party No. 9, and its sub-group on Electronic Commerce³³⁰, was approved by the Committee on Fiscal Affairs in January 1999 in order to investigate the progress of the Ottawa agenda and discuss further development; in February 2001 the Report was published³³¹. The group’s areas of focus were the practical application of the principle of taxation in place of consumption; the analysis of different tax collection mechanisms; and the examination of the possibilities for taxpayer and consumer identification, access to information and administrative simplification. The Report titled “Consumption Tax Aspects of Electronic Commerce” attempts a definite analysis of the contemporary issues and puts forward the most feasible solutions for defining the place of consumption as well as for assessing the collection mechanism options.

³²⁹ OECD, 2003 Report on the Implementation of the Ottawa Taxation Framework Conditions, <http://www.oecd.org/tax/taxadministration/20499630.pdf>

³³⁰ The Sub- Group’s members were: Australia, Canada, France, Germany, Ireland, Italy, Japan, Korea, Norway, the Netherlands, Sweden, Switzerland, United Kingdom, United States, European Commission and Singapore. They were also assisted by and benefited from the input of two of the five Technical Advisory Groups (TAGs)

³³¹ OECD; „Consumption Tax Aspects of Electronic Commerce“ – a report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, February 2001; www.oecd.org

The taxation guidelines by OECD may have only had advisory character initially but many jurisdictions, including the EU and US, have developed proposals for taxation in accordance with these 5 principles. The Taxation Framework Conditions can be regarded as the starting point for governments and tax administrations, as well as a significant point of reference for the emerging challenges in the area. As mentioned above the Ottawa principles tried to establish taxes to be levied where consumption occurs, as well as that there should be a simple registration scheme for non-resident vendors. This was the case under the Council Directive 2002/38/EC³³², and by the Council Directive 2006/58/EC.³³³ Such major changes in tax regulation can create debate on the issue. For example there has been a lot of criticism in the case of the EU Directive 2002/2³³⁴ and EU has taken the most sensible approach at the time to proceed with the initiative to charge VAT where the goods or services are consumed, rather than where the supplier may be located. According to that Directive there is no discriminatory treatment

³³² Official Journal of the European Communities, (2002), "Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services", L128/41 (15.5.2002)

³³³ Official Journal of the European Communities, (2006), "Council Directive 2006/58/EC of June 2006 amending Council Directive 2002/38/EC as regards the period of application of the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services", L174/5 (28.6.2006)

³³⁴ Edwin Tanner, Clear, Simple, and Precise Legislative Drafting: How Does a European Community Directive Fare? Statute Law Rev (2006) 27 (3): 150-175 doi:10.1093/slr/hml007

towards non-EU traders, and the Directive has also been subsequently approved by WTO³³⁵.

Besides the EU, other attempts have been made to tackle the issues presented to taxation by electronic commerce. Although most of the OECD signatory countries attempt to adopt an OECD-friendly approach, in some situations states would either take a step further or be rather deliberate to any proposals for regulation on this topic. The OECD continues after the Ottawa to publish working papers and advisory papers³³⁶ on the topic. There were some areas in the original Guidelines that required further clarification or research, which were dealt with the Working Party No. 9 report on Consumption Taxes. Also there has been a significant number of cases in the European Court of Justice³³⁷, showing that it has implications for and is a significant matter to many people, not only corporate bodies.

³³⁵EUROPA (2006) "How VAT works?" – "FAQ", http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/article_1610_en.htm

³³⁶ Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments, (February 2001) "Report to Working Party No. 1 of the OECD Committee on Fiscal Affairs, - Tax Treaty Characterization Issues Arising from Electronic commerce" (February 1, 2001). Also, OECD Working Party No. 9 on Consumption Taxes, "Consumption Tax Aspects of Electronic Commerce" (February 2001)

³³⁷ Kerckhaert-Morres v Belgische Staat, Reference for a preliminary ruling from the Hoge Raad Der Nederlanden by order of that court of 2 December 2005 in Investrand B.V. v Staatssecretaris van Financiën. [http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=EN&Submit=Rechercher\\$docrequire=alldocs&numaff=C-435/05&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100,](http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=EN&Submit=Rechercher$docrequire=alldocs&numaff=C-435/05&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100,) or http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_074/c_07420060325en00020002.pdf

The fundamental principle guiding the conclusions in the Ottawa Conditions was that the best approach to be taken by governments globally for the challenges presented by taxing online commercial transactions would be to use similar principles as they already use for the conventional commerce taxation. The OECD Ottawa conditions can assist in creating a more homogenous set of principles which can eventually achieve a better cooperative climate between jurisdictions on this area. By following the 5 Ottawa conditions and by all the different jurisdictions agreeing to a common solution then it will be more feasible to consider the notion of an internationally coordinated, if not harmonised, tax system applicable to electronic commerce. And because of the borderless nature of electronic commerce, its taxing can be a plan agreed by many of the interested parties; it does not have specified boundaries, so there is no reason why its regulation can only be considered from a limited, nationalistic perspective.

One of the main recommendations of the 1998 Ottawa Taxation Framework Conditions was that cross-border electronic commerce taxation should result in the jurisdiction in which consumption takes place, as was earlier mentioned. There are several reasons for that recommendation. It appears to be more advantageous for the parties involved. It prevents double taxation, or in certain situations, where two jurisdictions have extremely

non-compatible tax regimes³³⁸, accidental lack of any tax levy. This is a substantial area of work for the OECD and it is an area where criticism has been attached too³³⁹. However, it makes for a good argument on electronic commerce to be taxed upon and on the consumption location, as it should be easier nowadays to identify where consumption takes place and thus avoids lack of tax being levied at any point on of the procedure. Also it promotes more certainty as the consumer will need to identify their location for the purchase. In general the place of consumption would be the place of the recipient's address for delivery. The problem could arise with digitally delivered products and services, as the element of physical delivery is not part of the transaction.

Considering the definition of consumption tax it should refer to allocating it to the jurisdiction in which the actual consumption takes place; this definition would be similarly applicable to transactions whether they are B2B or B2C.³⁴⁰ In the case of B2B transactions the location of consumption will be deemed to be the location of the business; in case of more than one location (main offices, supply warehouse etc.) the consumption will be seen as taken place at the location where delivery was made. For B2C transactions it is perhaps more straightforward as the location of delivery will be

³³⁸ Sawyer, Adrian J. "Electronic Commerce: International Policy Implications for Revenue Authorities and Governments." *Va. Tax Rev.* 19 (1999): 73.

³³⁹ Cockfield, Arthur J. "Rise of the OECD as Informal World Tax Organization through National Responses to E-Commerce Tax Challenges, The." *Yale JL & Tech.* 8 (2005): 136.

³⁴⁰ OECD; „Consumption Tax Aspects of Electronic Commerce“ – a report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, February 2001; www.oecd.org

the place of residence of the consumer. OECD considered both B2B and B2C transactions and the consumption test, but electronic commerce can present certain complications, for instance if the seller has a consumer on the other side being simply a computer program designed and configured to purchase and download software or games or music. In this case is the consumption test one which can efficiently be applied and provide with a practical and enforceable solution on how to better assess the taxation concerns?

These questions could be answered by considering some common approaches taken both by the legislative as well as by the financial authorities. Credit card information can provide the information which indicates residence, and the ISPs could assist with providing the location identification data. The easiest way of course is by the customer providing their details to the vendor. The tax authorities would require the greatest degree of certainty and for this reason OECD tried to consider in 1998 and 2001 how to provide this degree of certainty. The Technology TAG after considering research done by the credit card industry³⁴¹ reached the conclusion that the consumers providing credit card information cannot be seen as adequate to give all the certainty the tax authorities would need. The Technology Tag concluded that customer's data relating to

³⁴¹ OECD, REPORT BY THE TECHNOLOGY TECHNICAL ADVISORY GROUP (TAG), 2000. Industry participants included American Express Company, Citigroup, Discover Financial Services, Inc., EuroPay, Household International, MasterCard International, Visa EU, Visa USA.

their credit card can sometimes not just be inadequate; they can also prove to be inaccurate³⁴².

The other possible solution is the location identification through the ISPs. The Tag considered this as a viable solution but concerns about the infrastructure and software not being very reliable. Other than the concern about the potential technological pitfall, another aspect the TAG considered could be problematic was the potential increase of costs of implementation and increasing transaction times.³⁴³ Application of using location identification could potentially impose a significant burden on the vendors, resulting in higher prices for the products paid for by the end consumer. TAG concluded that technical solution could benefit from better infrastructure and in connection with the use of digital certificates, a consumer's location could be assessed more successfully.³⁴⁴ All these complications and difficulties are more prominent in B2C transactions; in B2B transactions the companies will exchange information before the transaction takes place, as well as the factual element that companies' headquarters will need to be registered in a specific jurisdiction.

³⁴² Technology TAG, Report December 2000, page 27

³⁴³ *ibid*

³⁴⁴ Technology TAG, Report December 2000, page 7

The Ottawa Framework Conditions was a significant landmark, and helped to provide with the foundation of how to regulate the challenging area of online taxation. The Conditions and especially the five principles should be acknowledged as the guiding principles to tackle the challenges presented at that time. In Ottawa the principles put forward identified with the necessity to establish certain directions, on which governments would subsequently establish frameworks for the fiscal treatment of electronic commerce. Another element of the Ottawa Conditions is that they were illustrating the way OECD would proceed with future initiatives, especially on consumption taxation matters.³⁴⁵ The 1998 Ottawa Ministerial Conference, by producing the Taxation Framework Conditions, “forced” OECD to take the role of an “Informal World Tax Organisation”, something which some academics argue as a positive³⁴⁶. The fact that OECD assumed the initial responsibility to provide guidance for the electronic commerce taxation matters, and its subsequent success in ensuring a large number of its signatories followed or consulted the Framework Conditions signifies the existent necessity for an organisation to have that very crucial role.

³⁴⁵ OECD, The Application of Consumption Taxes to the International Trade in Services and Intangibles: Progress Report and Draft Principles, 2005

³⁴⁶ Cockfield Arthur, The rise of the OECD as informal “world tax organisation” through national responses to electronic commerce tax challenges, 2005, 8 Yale J.L. & Tech. 138 2005-2006

2.4 OECD and tax collection

The other element OECD Working Group examined was the tax collection mechanisms. The approach taken was that benefits from taxes outweigh its problems, including the possible administrative difficulties. With regard to online consumption taxes there are various approaches already in place and OECD considered some new ones as well. These mechanisms include: 1. self-assessment/reverse charge; 2. registration of non-residents; 3. tax at source and transfer; 4. collection by trusted third parties and 5. Other technology based solutions.

Under a self-assessment or reverse charge systems, recipients must determine a tax owing on imports of services and intangible property, and to remit this amount to the domestic tax authority. This system is currently adopted by most OECD member states for B2B transactions. It has proven effective, practical and does not incur a high compliance and administrative burden for the vendors involved³⁴⁷.

The registration system would create a system of implementing for non-resident businesses to register in a jurisdiction, where they carry out their business abroad, and

³⁴⁷ OECD; „Consumption Tax Aspects of Electronic Commerce“ – a report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, February 2001; www.oecd.org , p15

to charge, collect and remit the consumption tax to this country of choice for the registration. This approach is also seen as a practical and easy to establish, effective and would promote tax neutrality³⁴⁸. In the situation of needing to identify non-resident suppliers and sellers there may be complications; similarly, in imposing registration requirements and enforcing obligations on non-residents. Furthermore there can be a significant registration cost for non-resident as well as further hidden organic costs, such as employees, data gathering and processing, related to the registration. An alternative to avoid the significant costs is the tax at source and transfer option. A business will need to collect consumption tax on their exports to non-residents and pass on the amount to their domestic tax authority. The domestic tax authority would then forward that amount to the revenue authorities in the country of consumption. This alternative is considered to be less practical as it would require an extensive international cooperation, numerous agreements clarifying the enforcement, collection and revenue process.

Another approach suggested by OECD is the involvement of third parties for the collection of taxes. That would mean the tax authorities would have a supervisory role while third parties will bear the task of collecting the revenue. The Working Party discussed the feasibility of this solution and realized it can prove effective but the main

³⁴⁸

difficulty would be in having the responsibility of tax collection moved reallocated to trusted third parties³⁴⁹. Also, the discussion raised the matter of private enterprises being involved rather closely to what is seen as public administration matters. It would mean a drastic shift and change in the functionality and nature of tax administration within jurisdictions. Another solution could be the advancement of technology providing solutions feasible and further fitting to taxation regimes.

Another solution is the suggestion that for B2C transactions a zero VAT regime can be established³⁵⁰. Pure online transactions of B2C nature is not creating enormous revenues, compared to B2B commerce, therefore it would be more feasible to implement such measures. This proposal would create a basis of discrimination though. It would not be medium neutral; conventional delivery will have levy, while online digital delivery will not. OECD through the Working Party indicated that any of the proposed option would carry some complications and potential difficulties, but simplified registration for non-resident vendors would work perhaps better in a short-term basis, with the perspective of a technological development for an accurate tax regime as a future prospective. What is needed, and OECD has recognized this in their research, is a realization that the best solution will require an internationally close

³⁴⁹ OECD; „Consumption Tax Aspects of Electronic Commerce“ – a report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, February 2001; www.oecd.org , p16

³⁵⁰

relationship to result in a strong knitted cooperation of jurisdictions, as well as the appropriate use of the correct technological advancements. Overall, the importance of OECD in the field of taxation, and more specifically taxation of online transactions, is evidently very important and there is continuing research and the working papers made available indicating.

2.5 2006 VAT Guidelines

In February 2006 a project was launched in order to provide certain direction to governments on how to efficiently engage in the use of VAT (or goods and services Tax) for cross-border trade³⁵¹. As mentioned above, OECD having the informal role of an organisation working to develop international cooperation and development in the area of tax, and electronic commerce tax more specifically developed the International VAT/GST Guidelines. Without common ground, however basic that common ground may be, there is the danger of double-taxation, or severe lack of clarity in framework around cross-border trade³⁵². The 2006 Guidelines focus mainly on services and intangibles, and less attention is given to goods in cross border trade.

³⁵¹ OECD, International VAT/GST Guidelines, 2006, <http://www.oecd.org/ctp/consumptiontax/36177871.pdf>

³⁵² Chan, Clayton W. Taxation of Global Electronic commerce on the Internet: The Underlying Issues and Proposed Plans; 9 Minn. J. Global Trade 234 (2000)

The 2006 Guidelines reemphasize the main foundations for OECD countries; VAT is to be charged at the place of consumption for services and intangibles, and the taxable business does not carry the burden of VAT, unless the legislation prescribes it. These two guidelines have become more enshrined into the OECD countries taxing and financial attitude towards online cross country trade. To allow for such set of guidelines to efficiently operate across jurisdictions, there needs to be clarity on what is meant by “jurisdiction of consumption”. This is looked at Chapter 2 B.1 of the Guidelines, although even the clarity in a definition still will face difficulties in different tax regimes in different OECD countries³⁵³, with different cultural understanding of taxation and its regulation. The 2006 Guidelines are a very well developed initiative by OECD, attempting slowly to create a harmonized basis on which the OECD countries will share a similar understanding and be able to cooperate for cross-border taxation of online transactions relating to intangibles, mainly, and tangibles. OECD has helped many jurisdictions

³⁵³ Francisco A. Laguna, J.D, International Trends: Sales, Use and Consumption Taxation of Electronic commerce, 2002, Revista e-Mercatoria Vol 1, No 1 (2002), Universidad Externado de Colombia

3. The approach in the US

Tax is a very jurisdictional as well as a very global matter. In the United States it has developed significantly to now claim a generous percentage of the total sales occurring in America. The growth of electronic commerce transactions is a matter of vital importance to the development of trade as a whole. It is another representation of commerce rather than a completely different species. The information provided in the US Census quarterly retail e-commerce report indicates how rapidly electronic commerce grew within the last decade, thus providing an indication of the potential for further growth.³⁵⁴ The United States Bureau of the Census estimated that the Total retail sales for just the first quarter of 2015 were at \$1,151.2 billion, with electronic commerce approximately \$80 billion accounting for almost 7% of the total quarterly retail sales in the US, compared to \$25 billion and approximately 2% of the total retail sales in the first quarter of 2006. That amount was 16.5% of all U.S. shipments and sales in that quarter. Other estimates indicated that for the 2014 online retail industry would be at the \$251 billion worth in US presenting just within a year a rate of 14% increase to the year before³⁵⁵.

³⁵⁴ Quarterly U.S. Retail E-commerce Sales:
1st Quarter 2015, https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf, May 2015

³⁵⁵ Von Julian Heck, 2015, E-Commerce-Studie: Online-Shopper geben 2015 mehr Geld aus, <http://etailment.de/thema/studien/E-Commerce-Studie-Online-Shopper-geben-2015-mehr-Geld-aus-3038>, February 2015

The EU and the US took different policy positions when applying consumption taxes on electronic commerce. US did identify the challenges for tax from electronic commerce at an early stage, being the technical leader in the development of the technological aspects as well as the legislative/administrative ones. Considering consumption taxation, US does not employ VAT, but a system of sales tax. Sales tax is a levy on the sale of certain tangibles and services, sold traditionally over the counter to the buyer. There are three main elements that assist in determining when sales tax liability will be arising; the type of good being sold, the location where transaction takes place, and sufficient presence in that specific jurisdiction (nexus). "The general sales or turnover tax thus applies in principle to the supply of goods and services, irrespective of their distribution through traditional or electronic channels and irrespective of the physical or digital form of the goods"³⁵⁶. As with the VAT, the consumer pays for the sales tax at the time he purchases the goods, and the seller operates also with another role; he operates as an agent for the tax authorities by collecting and submitting the tax. Vendors must have licences and when the purchaser pays the tax to them they become responsible for collecting and returning the tax to the relevant state. Sales Tax being a State tax, and not federally enforced and regulated, is dependent on the individual State to define it.

³⁵⁶ Doernberg Ricard and Hinnekens Luc, 1998, *Electronic Commerce and International Taxation*, Kluwer Law International

An example is the State of Wyoming which states clearly what is seen as falling within the sales tax umbrella. "To understand what is actually taxable, it is necessary to understand what tangible personal property is. Tangible personal property is defined as property which is neither intangible personal property nor real property. It is personal property which may be seen, weighed, measured, felt, touched or which is in any other manner perceptible to the senses."³⁵⁷ Sales taxes are especially important to certain States, like Florida, Nevada, South Dakota, Washington, and Wyoming, which have no state income taxes, and to New Hampshire and Tennessee, which have only limited income taxes. In Florida, for example, sales taxes provide 34 percent of all state and local tax receipts.³⁵⁸

In addition to sales tax, states impose a Use Tax, when the goods are bought outside the borders of the state in question but used within the state; use tax will only be levied if sales tax has not being already imposed. It is seen as a complimentary tax to the Sales Tax, to cover only the out-of-state purchases, and it can be seen as a mechanism to balance the benefits and costs of in-state vendors to the out-of-state ones who are

³⁵⁷ Wyoming Vendor Manual; Compliance through education, 2007, State of Wyoming - Department of Revenue - Excise Tax Division, <http://revenue.state.wy.us/PortalVBVS/uploads/Vendor%20Manual.pdf>

³⁵⁸ Mazerov M, Making the ITFA permanent could lead to a substantial revenue loss for states and localities, Centre on Budget and Policy Priorities, August 2007, <http://www.cbpp.org/files/7-11-07sfp.pdf>

required to collect the local sales tax³⁵⁹. Use tax has been said to be “an ingenious legal device that was developed to safeguard state sales tax by imposing tax on the privilege of using, consuming, distributing it storing tangible personal property after it is brought into the State from without the State”³⁶⁰. Rates for use tax and sales tax will usually be the same, considering they are both different formulations of the same rule³⁶¹. Use tax is most effective towards sales of tangible goods but faces difficulties in relation to enforcement against services purchased outside of the State’s boundaries, but subsequently executed in the State. Pragmatically, use taxes are avoided by sellers unless a collection burden is imposed on the seller, which is rather difficult in the scenario where nexus is not sufficient in a jurisdiction. In that case, the consumer can be asked to self-assess use-tax, which is very problematic since individuals do not go through tax audits³⁶².

The United States is a federal union with numerous varied sales tax regulations, a great amalgamation of jurisdiction where the international taxation principles can be examined in depth; it starts at the top with the Constitution and proceeds to different set of rules in different individual States. Within EU there is a common levy in the form

³⁵⁹ Wyoming Vendor Manual; Compliance through education, 2007, State of Wyoming - Department of Revenue - Excise Tax Division, <http://revenue.state.wy.us/PortalVBVS/uploads/Vendor%20Manual.pdf>

³⁶⁰ State Taxation, Hellerstein J.R. & Hellerstein W. (1998)

³⁶¹ State Taxation, Hellerstein J.R. & Hellerstein W. (1998)

³⁶² Masters of complexity and bearers of great burden; the sales tax system and compliance costs for multistate retailers, Cline R. & Neubig T. (1999)

of VAT, though the percentage varies amongst Member states.³⁶³ The main difference between the two jurisdictions is that sales tax is a state tax and not a federal-USA wide tax; each state within the US is entitled to levy different sale tax rates, and what creates more complexity is that each state also collects this tax on different products, because the definitions of services and goods vary from State to State.

Overall, there are more than 7.500 different tax rules in the USA³⁶⁴, which makes it obvious that smaller companies have a lot more to correspond to, which makes it impossible for them to follow all expenses and administrative hassle. For instance, Wyoming, which was mentioned above, has a 4% Sales Tax³⁶⁵, but since the rate is not federally regulated, different States can impose significantly different rates and in some States such as Alaska, Delaware and Montana, the rate of Sales Tax is 0%.³⁶⁶ A 4% sales tax on the purchase of a \$20,000 car in Wyoming would produce \$1,200 in sales tax. The difference in policies amongst the States regarding sales tax is also creating an obstacle in taxing electronic commerce, where some degree of harmony is crucial to interlink VAT and Sales Tax systems. Sales tax is probably straightforward in its application for

³⁶³

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf

³⁶⁴ As discussed in the 1992 decision, *Quill v. North Dakota* (U.S. Supreme Court)

³⁶⁵ *ibid*

³⁶⁶ Scott Drenkard, 2011, Tax Foundation Fiscal Fact No. 284: Ranking State and Local Sales Taxes, <http://taxfoundation.org/article/ranking-state-and-local-sales-taxes-1>

conventional commerce by a single store or a chain within a state, but when the considerations involve cross-state then online retailers are faced with numerous complicated different regulations and rates of tax at state and local level.

3.1 US case law

There are two basic legal decisions in the US that have been decisive over taxation matters, to the extent of allowing or stopping a state collecting the taxes after a specific transaction. These two cases decided in the US Supreme Court are the National Bellas Hess v. Department of Revenue³⁶⁷ and Quill Corp. v. North Dakota³⁶⁸. Deciding these two cases the court ruled that a state may not require a seller that does not have a physical presence in the state to collect tax on sales into the state. The Court, also, ruled that the existing system was too complicated to impose on a business that did not have a physical presence in the state. The Court said Congress has the authority to allow states to require remote sellers to collect tax. Specifically in Quill v. North Dakota, the US Supreme Court reaffirmed its position on state taxation: "[i]n the absence of some nexus of the vendor to the taxing state, no state can compel collection of its sales tax by an out of state vendor without authorization from Congress."³⁶⁹ These two cases have

³⁶⁷ <http://supreme.justia.com/cases/federal/us/386/753/case.html>

³⁶⁸ <http://supreme.justia.com/cases/federal/us/504/298/case.html>

³⁶⁹ Quill v. N. Dakota, 504 U.S. 298 (1992)

caused significant problems to the regulation of online transactions and have made it paramount that the seller must establish nexus within that jurisdiction for that state then to require them to collect sales taxes.

3.2 Clinton Administration

In the mid-1990s there was significant discussion in the US exploring ways in which individual states would be able to consider Internet services as a new tax base and tax it accordingly³⁷⁰. A year later the Clinton Administration took the discussion on to a federal level, resulting in the paper “Selected Tax Policy Implementations of Global Electronic Commerce”³⁷¹ addressing the issue of source vs. residency as well as the importance of neutrality relating to the taxation of online commerce³⁷². The purpose of the Treasury report was “to provide an introduction to certain income tax policy and administration issues presented by developments in communications technology and electronic commerce”³⁷³. It covered the most important issues related to supply, location of server, goods or services distinctions.

³⁷⁰ Newman, 1995

³⁷¹ www.ustreas.gov/taxpolicy/internet.html

³⁷² US Department of Treasury 1996, <http://www.treasury.gov/resource-center/tax-policy/Documents/internet.pdf>

³⁷³ *ibid*

In 1997 the White House published the “Framework for Global Electronic Commerce”³⁷⁴, with a chapter only discussing electronic commerce taxation, where the decision was not to create any new taxes for electronic commerce & to keep Internet tariff-free when used for delivery of products or services. The Framework’s main suggestion, in relation to online environment and tax, was a moratorium on imposing new taxes for electronic commerce, and that moratorium was directed in a way as to be applicable across the globe³⁷⁵. The Clinton Administration proposed a system of VAT, levied at the point of consumption and collectable immediately with the sale³⁷⁶. The collected taxes then would be channelled to the respective State tax authorities via the use of an agent, which Chan claims would bring in the revenue faster and it would make the process easier and more efficient for seller and consumer as well as for international cooperation between EU and the US³⁷⁷, as well as create a more solid basis for online consumer trust, especially in relation to their online privacy.³⁷⁸

³⁷⁴ [http://www.w3.org/TR/NOTE-framework-970706.html#Annotated Version](http://www.w3.org/TR/NOTE-framework-970706.html#Annotated%20Version)

³⁷⁵ Lymer A. 2003, *Taxation in an Electronic World*, (in Lamb, Lymer, Freedman & James (editors) 2005 *Taxation: An Interdisciplinary Approach to Research*, OUP)

³⁷⁶ Strassel A.K. and Schenker J. L, 1998, *OECD Summit to Focus on Internet-Tax Collection*, Wall St. J. Europe, Sept. 15, 1998

³⁷⁷ *Taxation of Global Electronic commerce on the Internet: The Underlying Issues and Proposed Plans*, <http://www.winthrop.com/portals/0/pdf/claytonchan.pdf>

³⁷⁸ Budnitz M. E., 1998, *Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate*, 49 S.C. L. Rev. 847 (1998)

3.3 Internet Tax Freedom Act

One other very significant development, following from the White House 1997 publication, was the Internet Tax Freedom Act of 1998, a federal rule by the Congress to forbid any laws that would tax transactions conducted over the Internet. This Act was intended to be a temporary one, with an initial period of 3 years. Main reason for the temporary character was to gain time and investigate the effects of Electronic commerce upon society, law and the economy more efficiently and on a USA-wide perspective.³⁷⁹ President Bush extended the Act for 2 more years until November 2003³⁸⁰, despite some of the Congress raising their concerns, and argued over the necessity for simplification of the sales tax system.³⁸¹ This Act exempts Internet access services from state and local taxes, such as sales tax, and it applies to all states, excluding the ones (about 10 States) that had related policy frameworks in place before 1998. The Act originally imposed the three-year moratorium on the state and local taxation of Internet access³⁸². Internet access for the purposes of the Act was defined as *“A service that enables users to access content, information, electronic mail, or other services offered over the Internet, and may also include access to proprietary content,*

³⁷⁹ Section 1102 par. G Internet Tax Freedom Act

³⁸⁰ www.jointventures.org/initiatives/tax/tax_itfa.html

³⁸¹ Hardesty, “Internet Tax Freedom Act Extended”, December 2001

³⁸² 47 U.S.C. section 151 at section 1101(a)(1) (1994 & Supp.4 1999).

information, and other services as part of a package of services offered to users. Such term does not include telecommunications services".³⁸³

However, Congress specifically excluded from the moratorium any taxes that had been enacted and enforced³⁸⁴ before the Act via a grandfather provision; this exception also known as "the ITFA grandfather clause".³⁸⁵ This Act prohibited the introduction of discriminatory, non-neutral taxes (not imposed on transactions done with other means) on electronic commerce transactions, or invention of new taxes. The Act is only related to intangibles and electronic commerce transactions; it does not affect sales of tangible products over the Internet. Generally speaking, the purpose of this Act was to encourage the development of the Internet by preventing individual states from imposing taxes on Internet access, multiple taxes on a single electronic commerce transaction, and discriminatory taxes aimed toward commerce conducted over the Internet.³⁸⁶

3.3.1 ITFA and criticism

In the last few years this Act's unpopularity has been growing, especially from the States' perspective as they claim the prohibition does not allow them to tax otherwise

³⁸³ Id. at section 1104(5)

³⁸⁴ Id. at section 1101(d)

³⁸⁵ Section 1101 par. A Nr. 1 Internet Tax Freedom Act; Fetzner, op cit, page 36

³⁸⁶ Maguire S. and Noto A. N, Congressional Research Service, Report for Congress RL33261, Internet Taxation: Issues and Legislation in the 109th Congress (Feb. 2, 2006).

taxable transactions merely because they take place online. A 2005 study indicates that online retail sales in the United States will grow from US\$172 billion in 2005 to US\$329 billion in 2010³⁸⁷, which illustrates the argument that the ban is costing billions of dollars (\$1.8 billion in sales and use taxes in 2004) and the figures expand as the volume of transactions grow³⁸⁸. Despite the concerns, the House of Representatives ruled to continue the prohibition, and with the intention to extend the scope and to become permanent.³⁸⁹ On December 2004 it was decided to amend (reaffirming the tax-exempt status of internet access, and widen its meaning) and extend the Act until November 2007,³⁹⁰ thus allowing more time for the States to create a more solid unified approach.³⁹¹ It has been extended by the United States Congress for the third time, which was titled the Internet Tax Freedom Act Amendment Act of 2007³⁹², and was signed into law on November 1, 2007, by George Bush thus extending the moratorium until November 1, 2014.

³⁸⁷ Carrie A. Johnson and Brian Tesch, "US eCommerce: 2005 to 2010--A Five-Year Forecast and Analysis of US Online Retail Sales", September 14, 2005, at <http://www.forrester.com/Research/Document/Excerpt/0,7211,37626,00.html> [Accessed December 19, 2007]

³⁸⁸ www.hklaw.com

³⁸⁹ www.heritage.org/research/internetandtechnology/wm424.cfm

³⁹⁰ Basu, Global perspective on Electronic commerce Taxation Law, p 207

³⁹¹ Brooks, Barrett (2005) Electronic commerce and States Sales Tax, Journal of State Taxation, 24, 2 pp 47-49

³⁹² <http://www.gpo.gov/fdsys/pkg/PLAW-108publ435/content-detail.html>

This Act could potentially mean State Governments losing huge sums of money, by endangering their tax collection³⁹³. The Act was important as it disallowed the states from imposing new or discriminatory taxes on electronic commerce by the means of the moratorium. The initial introduction of the ITFA initially caused excitement between many businesses considering it as providing freedom from any taxes for the Internet³⁹⁴. What it did though was impose prohibition towards any new fiscal measures on internet access services, stop States to impose a variety of discriminatory taxes on electronic commerce, and lastly it contained the grandfather clause, thus allowing the states to impose any charge, that was in existence before the enactment of the ITFA, on internet access.³⁹⁵ The heated debate around it created the climate of some States wanting to expand their sales taxes to include Internet access charges; the States have been divided to two groups about how aggressively they want to impose consumption taxes on electronic commerce³⁹⁶. Currently The Internet Tax Freedom Act is not a favoured approach in the States, despite the intention by the Congress to make the ban permanent. The preferred approach seems to be the one represented by the “Streamlined Sales Tax Project”³⁹⁷, which aims to simplify the sales tax system and make

³⁹³ Burke T. Ward & Janice C. Sipior (2011): The Battle Over Electronic commerce Sales Taxes Heats Up, Information Systems Management, 28:4, 321-326 (also “More states propose Internet sales taxes”, http://news.cnet.com/8301-13578_3-10465658-38.html, Declan McCullagh, March 8, 2010)

³⁹⁴ ITFA, 105 H.R. 4328, 105 P.L. 277, 112 Stat 2681 (1998)

³⁹⁵ *ibid*

³⁹⁶ Basu, Global perspective on Electronic commerce Taxation Law, p 205

³⁹⁷ <http://www.streamlinedsalestax.org/>

the 7.500 different rules into one harmonized set of rules for taxation applicable to all the US States.

It appears that in the US the federal government has adopted a wait-and-see approach in relation to Internet and electronic commerce taxation, however not everyone is agreeing with that approach. State governments have protested loudly that the ban is not cost-effective for the states because it allows otherwise taxable transactions to escape taxation simply because they occur over the Internet. State governors have lobbied for gaining the power to tax electronic commerce transactions. To that extent 42 governors had sent letters to Congress opposing Internet Tax Non-discrimination Act or its equivalent as of September, 2001³⁹⁸. If that was to move forward, up to this point there has been no significant development on this initiative; states could potentially lose sales tax revenues. The consumers will be able to choose to purchase goods via the Internet and avoid paying state sales taxes.³⁹⁹ If such an initiative would materialize then different states would attract businesses to relocate their offices and distribution centres to areas where sales tax is not imposed⁴⁰⁰. Many traditional companies with a physical presence in each state where they generate transactions could be losing ground to low-overhead, non-tax-burdened, electronic commerce firms. Governments can

³⁹⁸ P. Greg Gulick, The Internet's Impact on State Tax Systems, 33 URB. LAW. 479, 495 (2001)

³⁹⁹ Anita Horn, Internet Transaction Taxes: The Need for Jurisdictional Integration, 9 COMMLAW CONSPECTUS 29 (2001)

⁴⁰⁰ John C. Beck, Get a Grip! Regulating Cyberspace Won't Be Easy, BUS. L. TODAY, May/June 2001

hardly expect bricks-and-mortar companies to continue to pay taxes on the same sort of transactions that go untaxed with electronic commerce companies."⁴⁰¹ Currently the moratorium is imposed on charging any new taxes or any discriminatory taxes on electronic commerce, but there is still inconsistency on a national level, and states still cannot overcome the restraints posed by the Quill decision and out-of-state online vendors do not have to pay taxes on electronic commerce sales.⁴⁰² This was the reason states took an initiative for something that could help them by ensuring there is uniformity across the US, without leaving gaps for online sales. Overall it should be mentioned of course that the ITFA does not pose a threat or a developmental opportunity on sales and use taxation; strictly under the provisions of the ITFA electronic commerce is not exempt from taxation⁴⁰³. However it does indirectly help create better protected internet access, protected from State and federal regulation imposing tax in order to regulate internet access. Another positive outcome of the ITFA is also the establishment of the Advisory Commission on Electronic Commerce (ACEC) to study electronic commerce related matters and report to Congress on these matters.

⁴⁰¹ John C. Beck, Get a Grip! Regulating Cyberspace Won't Be Easy, *Bus. L. TODAY*, May/June 2001

⁴⁰² Nonna Noto, Extending the Internet Tax Moratorium and Related Issues, in *Internet Taxation* 18, 36 (Albert Tokin ed) Novinka Books, 2003

⁴⁰³ Burke T. Ward, Janice C. Sipior & Labhras MacGabhann (2012) The E-Commerce Sales and Use Tax Controversy: Is the End Near?, *Information Systems Management*, 29:4, 331-337, DOI: 10.1080/10580530.2012.716995

3.4 Streamline Sales Tax Project and Streamlined Sales and Use Tax Agreement

An attempt was made by some of the States in order to create a framework to convince out-of-state vendors to collect sales taxes, when they were the vendors of electronic commerce transactions with in-state consumers; that initiative was initially identified as the Streamlined Sales Tax Project (SSTP or subsequently the Streamlined Sales and Use Tax Agreement (SSUTA))⁴⁰⁴. Amongst the provisions of the Internet Tax Freedom Act was the establishment of the Advisory Committee on Electronic Commerce⁴⁰⁵ examining the crucial issues relating to taxation and electronic commerce, and report back to the US congress. In March 2000, the Streamlined Sales Tax project was organized to simplify the collection and administration of sales and use taxes by retailers and states. The outcome of this work was the Streamlined Sales and Use Tax Agreement (SSUTA). The purpose of the SSUTA is to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance. Instead of extending the ITNA, many of the states in the US rather prefer to simplify their system of sales tax. In order to simplify their collection systems the states representation, the National Governors Association, has founded the “Streamlined Sales Tax Project” in 2000 aiming for uniform and simplified use and sales tax system. This project is aiming to simplify the current rules and is intending to present its final

⁴⁰⁴ <http://www.streamlinedsalestax.org/>

⁴⁰⁵ <http://govinfo.library.unt.edu/ecommerce/index.htm>

proposal in 2006. Currently there are over 7500 different rules regulating sales tax in the US. The project intends to establish one rule. Then it would be practical to levy sales taxes also on the currently banned services.

Currently there are 24 states which passed legislation conforming to the Streamlined Sales Tax Project and over thirty have agreed to join the SSTP⁴⁰⁶. The SSTP proposals include state level administration of sales and use tax collections, uniformity in the tax bases, a central electronic registration system even consumer privacy protections, in order to make it easier for electronic commerce companies to collect taxes through the use of available technology and for the online consumers⁴⁰⁷. Registering for the SSTP means states would pay for the implementation of tax-collection systems⁴⁰⁸. SSTP as a concept could have wider application as its main aim from the beginning stage of its development to the subsequent form of Streamlined Sales & Use Tax Agreement was to simplify and create a more uniform approach⁴⁰⁹. Section 102 specifically reads that “the purpose of this Agreement to simplify and modernize sales and use tax administration in the member states in order to substantially reduce the burden of tax compliance. The Agreement focuses on improving sales and use tax administration systems for all sellers

⁴⁰⁶ Streamlined Sales and Use Tax Agreement, http://www.streamlinedsalestax.org/uploads/images/state%20map%2008_01_11.jpg

⁴⁰⁷ <http://www.streamlinedsalestax.org/index.php?page=faq>

⁴⁰⁸ Multistate Tax Commission, Public-Private Sector Study of Cost of Collecting State and Local Sales and Use Taxes, <http://www.mtc.gov/Resources.aspx?id=170>

⁴⁰⁹ Maguire, Steven 2011, "State Taxation of Internet Transactions", Congressional Research Service.

and for all types of commerce”⁴¹⁰ For instance, one of the Agreement’s proposal that could be employed in other jurisdictions and provide a feasible solution in relation to international taxation question is the use of a centralized registration system. Vendors would register in each state, leaving states to allocate appropriate funds to each municipality within the state helping to minimize the 7,500 tax municipalities in the U.S. alone⁴¹¹.

The Streamline Sales approach has been seen as a potential beneficial move to a better and more efficient tax system which will encompass the positive elements of both sales tax system and electronic commerce technological framework.⁴¹² It has been seen as a good move forward since it established simple and uniform rules relating to what are taxable goods and services and the participating members are under the obligation to utilise these rules⁴¹³. Also it introduced a clear and concise category of products called “digital goods”, which allowed for a uniform approach to all members.⁴¹⁴ Overall, the

⁴¹⁰ SSUTA S.102

<http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%20through%205-13-15.pdf> (May 2015)

⁴¹¹ David E. Hardesty, (2000) Taxation of Electronic commerce: Recent Developments, 618 PLI/PAT 177

⁴¹² Hale Kathleen, McNeal Ramona, Technology, politics, and electronic commerce: Internet sales tax and interstate cooperation, Government Information Quarterly, Volume 28, Issue 2, April 2011, Pages 262-270 (<http://www.sciencedirect.com/science/article/pii/S0740624X10001449>)

⁴¹³ Streamlined Sales and Use Tax Agreement, paragraph 327

⁴¹⁴ Collins, The Streamlines Sales Tax Agreement: What it means for business, 55 Tax Executive (issue 1), jan/feb 2003

Streamlined project was seen as a very efficient step forward⁴¹⁵, but not with complete success as there are still concerns about the privacy of the consumers as well as the lack of directions on the cooperation of the members, and the major pitfall may be the application of the Streamlined project without infringing the commerce clause of the decision in Quill.⁴¹⁶ In regards to this last reference, there may be potential concerns over the functionality of the Agreement's provisions without creating any obstacles to the commerce clause from the US Constitution. That specific clause gives the authority to the Federal Government to have the overreaching power in regards to imposing and collecting taxes⁴¹⁷. In regards to electronic commerce, that clause can offer the Federal Administration the power to supervise and correct any potential regulation or taxes imposed by one State, if there is a strong probability it will disadvantage another State or create problems for interstate commerce. In the Quill the Court did rule on the importance of nexus but also allowed for Federal overruling this by enacting legislation to that extent⁴¹⁸. This is a potential mishap of the Agreement as it could sidestep the Quill decision and with that circumvent the importance of nexus in regards to electronic commerce taxation.

⁴¹⁵ McGaffrey, Wisconsin Tax Policy within a Federal System, 88 MARQ. L. REV. 93, 99-100

⁴¹⁶ Reese, Does the Streamlined Agreement Signal the End of Quill in the Area of Electronic commerce?, 29 ST. TAX NOTES 639, 648 (2003)

⁴¹⁷ Cornell University Law School, US Constitution, <https://www.law.cornell.edu/constitution/articlei>

⁴¹⁸ Quill Corp. v. North Dakota (91-0194), 504 U.S. 298 (1992).

3.5 Marketplace Fairness Act

The Marketplace Fairness Act⁴¹⁹ is proposed legislation in the US which could grant States the right to collect sales taxes and use taxes at the time of transaction from remote retailers with no physical presence in their state; almost like local retailers are required to do. The MFA is one of three “remote seller” bills currently in Congress

Attempting to correct Quill⁴²⁰ However, the states will only be given that right if they have simplified their sales tax laws. The MSFA’s condition is SSUTA membership; the MEA’s conditions are set out in “minimum simplification requirements”. Those who want to be able to use the MFA have two options:

“Option 1: A state can join the twenty-four states that have already voluntarily adopted the simplification measures of the Streamlined Sales and Use Tax Agreement (SSUTA), which has been developed over the last eleven years by forty-four states and more than eighty-five businesses with the goal of making sales tax collection easy. Any state which is in compliance with the SSUTA and has achieved Full Member status as a SSUTA implementing state will have collection authority on the first day of the calendar quarter that is at least 180 days after enactment.

⁴¹⁹ Marketplace Fairness Act of 2013, <https://www.congress.gov/bill/113th-congress/senate-bill/743>

⁴²⁰ Ainsworth, Richard Thompson and Madzharova, Boryana, (2013) Leveling the International Playing Field with the Marketplace Fairness Act (June 14, 2013). Boston Univ. School of Law, Law and Economics Research Paper No. 13-25. Available at SSRN: <http://ssrn.com/abstract=2279449> or <http://dx.doi.org/10.2139/ssrn.2279449>

Option 2: Alternatively, states can meet essentially five simplification mandates listed in the bill. States that choose this option must agree to:

1. Notify retailers in advance of any rate changes within the state
2. Designate a single state organization to handle sales tax registrations, filings, and audits
3. Establish a uniform sales tax base for use throughout the state
4. Use destination sourcing to determine sales tax rates for out-of-state purchases (a purchase made by a consumer in California from a retailer in Ohio is taxed at the California rate, and the sales tax collected is remitted to California to fund projects and services there)
5. Provide free software for managing sales tax compliance, and hold retailers harmless for any errors that result from relying on state-provided systems and data”⁴²¹

The EU and the US are going towards the same direction by adopting very similar approaches. The MFA is a positive step forward; creates a levelling mechanism to EU’s regulation and that subsequently can allow for further cooperation. Also, it presents a positive step towards Federal regulation in the US, something which appears to be an

⁴²¹ Market Fairness Act, <http://marketplacefairness.org/what-is-the-marketplace-fairness-act/>

important element for such a piece of legislation to operate fully⁴²². Even though it is generally perceived as a significant step forward there are some concerns and criticism towards the MFA. One criticism lies in that a new federal tax will be created, raising the argument on its constitutionality. This criticism is not one to be seen as valid though, due to the fact the Congress has the authority to enact such legislation, following the Quill case.⁴²³ Another criticism is the creation of unconstitutional undue burden on interstate commerce, which similarly to the one above, it is highly unlikely the Act will be found unconstitutional⁴²⁴.

4. Conclusion

Electronic commerce has grown tremendously in a short time, and is forecast to grow even more in the near future. A coordinated and consistent global tax policy is a rational response to the issue of how to manage valuable tax revenues from this new transactional medium. OECD has assumed the role of the organization encouraging cooperation and development in that area and produced significant motivation for the two biggest actors of online commercial transactions, EU and the US. EU is going to be

⁴²² State taxation was first addressed in *National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois* 386 U.S. 753 (1967).

⁴²³ Bryan J. Soukup, (2013) *Close The Loophole: The Marketplace Fairness Act and its Likely Passage*, Inside Basis, Fall 2013, at 16.

⁴²⁴ *ibid*

examined in the following chapter, while previously and in order to set the overall background for this discussion the influence of the OECD was argued as well as how evident that influence is in the legislation and related policy initiatives of the two main actors. The US did accept the OECD guidance on an initial basis but then decided to take a more “hands off” approach, contrasting the EU one. The US has taken some very significant steps to identify and control the online commercial arena, but not by creating legislation for every eventuality. Instead the US approach has been to keep a balance between tax compliance, transactional freedom for development for electronic commerce and simplicity on the practical aspects for the consumer⁴²⁵.

There is the belief amongst some tax lawyers that the sales tax streamlining movement should be considered as one of the most significant development in state sales taxation since the initial establishment of the state sales tax in the 1930s, and an initiative which can ultimately help increase, any lost⁴²⁶, revenue for the States⁴²⁷. Also, the Streamlined Sales and Use Tax Agreement should create the circumstances for easier cooperation on a cross-border and international perspective, thus allowing for a better planning and

⁴²⁵ ⁴²⁵ Burke T. Ward & Janice C. Sipior (2011): The Battle Over Electronic commerce Sales Taxes Heats Up, *Information Systems Management*, 28:4, 321-326 (also “More states propose Internet sales taxes”, http://news.cnet.com/8301-13578_3-10465658-38.html, Declan McCullagh, March 8, 2010)

⁴²⁶ James P. Kratochvill and Pilar M. Sansone, Too Many Grandfathers Spoil the Broth: The Failure of the Internet Tax Nondiscrimination Act?, *Tax Analysts* 2007, <http://www.mofo.com/files/Publication/7a5636f9-b6fb-41f0-a870-086eff2a823f/Presentation/PublicationAttachment/5286c4eb-bfef-4620-b6e8-0e18b9e034e9/071001StateTaxNotes.pdf>

⁴²⁷ JA Swain, W Hellerstein, The Political Economy of the Streamlined Sales and Use Tax Agreement, *National Tax Journal*, 2005

potential implementation of a more harmonised global system for taxing electronic commerce.⁴²⁸ However, despite all the positive aspects of the project, some academics such as Basu present the argument that the constitutional obstacle of the Quill decision and the dormant Commerce Clause make the Streamlined Sales and Use Tax Agreement merely an influence mechanism directed to the Congress and their legislative efforts⁴²⁹, which could move forward with the Marketplace Fairness Act, creating a more level playing field with the respective EU initiatives.

⁴²⁸ Francisco A. Laguna, J.D., International trends: Sales, use and consumption taxation of electronic commerce, *REVIST@ e – Mercatoria* Volumen 1, Número 1. (2002)

⁴²⁹ Basu, *Global perspectives on Electronic commerce taxation law*, Ashgate, 2007

5. The approach of the European Union

Contents

5. The approach of the European Union	197
1. Introduction	200
2. EU specific developments relevant to taxing electronic commerce	202
2.1 Relevant background	203
2.2 6th VAT Directive	214
2.3 Current initiatives	222
3. Is EU being efficient?	236
3.1 EU Directive: a good thing?	238
3.2 What next? Opportunities or retaliation? The Regulation (EU) No 1042/2013	247
4. Conclusion	251

This Chapter will look at an important aspect of the thesis: the approach taken by the European Union on taxing electronic commerce. It will examine the regulatory initiatives taken by the European Union in relation to taxing online transactions, specifically towards the taxation regime established by the Union to efficiently deal with the potential implications posed by online commercial transactions. Looking at the main institutions operating in this area and their role in developing the VAT specific and other related regulatory approaches, the merits of the EU approach can be considered. The development of the relevant regulation within the EU will be examined in depth. Starting the discussion by consideration of the initial steps towards developing and establishing a common market, namely the Treaty of Rome and the 1992 Maastricht EU Treaty, both relevant as to their assistance to establish the main principles of the European Market, the framework within which EU subsequently had to address the electronic commerce taxation matter. Also, this chapter will focus on the subsequent and more contemporary attempts by EU in producing regulation to deal with the implications assumed by VAT and electronic commerce. After examining the framework established by the Union, this chapter will attempt an evaluation of the policy in this area, as well as present the degree of criticism this framework has received.

1. Introduction

As it has been discussed in previous chapters electronic commerce presents a significant danger and at the same time a great opportunity for governments and tax authorities. The constant growth and development of electronic commerce and the digitisation of goods and services pose questions in regard to the taxation processes, especially considering the taxation within a group of different Member States, the European Union. With more than 460 million inhabitants and a Gross Domestic Product of above EUR 11,000 billion (USD 13,300 billion), the European Union is a major economic player in the world⁴³⁰ and thus cannot risk losing a great amount of revenue due to online commercial activities. Even though electronic commerce has only been around the last

⁴³⁰EU – European Commission Economic Papers “Corporate tax competition and coordination in the European Union: What do we know? Where do we stand?” N° 250 June 2006, p4

couple decades, the development has been extraordinary, and the internet is now seen as a window to the global market arena. Because of that, from a legal point of view, there is currently a pressing need for approaching all the relevant regulation, in order to ensure a framework is in place allowing for further growth and development but at the same time not permitting uncontrollable conditions which traders will exploit for making profit.

The European Union is an intricate and multi-jurisdictional organisation. At the same time it has a distinct character from the Member States while its impact on domestic systems (on administrative, legal, financial matters) is evident to a great extent. One of the aspects of EU's operation is the taxation of Member States and its regulation. Tax law originating from the EU has a substantial impact on that of its Member States. European Union development of legislation and legal trends can be identified from looking at the key institutions and the jurisprudence of them (i.e. ECJ), as well as political and economic implications. Therefore, it is obvious that tax regulation is not a simple process, and especially in the case of European Union, which is the biggest single developed market in the world⁴³¹, with 27 countries and more than 490 million consumers⁴³².

⁴³¹ http://ec.europa.eu/development/policies/9interventionareas/trade_en.cfm

⁴³² http://ec.europa.eu/consumers/index_en.htm, Meglena Kuneva, European Consumer Commissioner

The main focus of this chapter will be the current legislation produced by the European Union, but before discussing that there are some other aspects which are vital to the understanding of the wider concept. A reference will be made to the previous regulatory attempts of relevance and their development, especially the ones focusing on Value Added Tax, to establish the starting point and the founding steps. The subsequent amendments and more contemporary Proposals and Directives on the issue of consumption taxation will be analysed. These include the Council Directive 2002/38/EC (initially as a temporary measure but subsequently extended by Council Directive 2006/58/EC and now having a permanent status⁴³³) and its rationale. Also a brief reference will be made to other elements of the taxation in EU, such as rates, the EU Institutional framework that affect significantly the creation and functionality of legislation relating to tax.

2. EU specific developments relevant to taxing electronic commerce

European Union has been a significant contributor in relation to producing policies and guidelines in the area of developing taxation frameworks directed to electronic

⁴³³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0011:0022:EN:PDF>

commerce. EU has taken huge steps to modernise the tax systems of the Member States over the last two decades.

E.U. has taken significant action to update their respective tax systems in light of the exponential growth and revenue implications of electronic commerce⁴³⁴. A comparison of the effects of sales and use tax jurisdiction's actions to those of a VAT system will lead to a deeper understanding of each system, how they operate alongside one another, and the areas for advancements in efficiency and fairness.

2.1 Relevant background

A significant section of primary legislation originating from the European Union (or rather European Community at the time) is the Consolidated Version of the Treaty Establishing the European Community as well as other ones of the founding treaties for the European Community.

2.1.1 Initial approaches

The Treaty of Rome, establishing the European Economic Community (EEC)⁴³⁵, signed in Rome on 25 March 1957, and entered into force on 1 January 1958⁴³⁶. The Treaty of

⁴³⁴ Burke T. Ward, Janice C. Sipior, Wayne G. Bremser, David B. McGinty, 2006, A comparison of United States and European union taxation of electronic commerce, , <http://web.sau.edu/LillisKevinM/csci660/2008Fall/papers/WardSipiorBremserMcGinty.pdf>

⁴³⁵ http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html

⁴³⁶ http://europa.eu/abc/treaties/index_en.htm

Rome, is considered mainly a historical piece of European legislation now, and has subsequently been replaced by the Treaty for the Functioning of the European Union⁴³⁷. The importance of the Treaty of Rome lies in its provisions and the reason for its creation. From a theoretical perspective the Treaty of Rome encouraged the closer union between the Member States. That was mainly due to the core principles raised and the actual outcome for EU and its citizens, mainly the fundamental Treaty freedoms⁴³⁸. These articles are identifying and establishing the fundamental freedoms; free movement of goods, of workers, of capital and payments, freedom of establishment and to provide services⁴³⁹.

Another reason why the Treaty of Rome is significant when discussing taxation and commercial transactions within EU is because the Treaty established four institutions - a Commission, a Council of Ministers, a European Parliament and a European Court of Justice⁴⁴⁰. These institutions were to be operated by qualified officials from all member states and were set up to attempt the creation of closer co-operation on a range of economic and trade issues from agriculture to overseas aid, commerce to taxation⁴⁴¹.

⁴³⁷ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:en:PDF>

⁴³⁸ Articles 23-31, 39, 43, 49 and 56 ECT

⁴³⁹ http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html

⁴⁴⁰ http://europa.eu/legislation_summaries/institutional_affairs/treaties/treaties_ecsc_en.htm

⁴⁴¹ *ibid*

Not all the articles are related to taxation, and articles 23-31, 39, 43, 49 and 56 ECT are identifying the fundamental freedoms provided by the Treaty. Title 6 (Title VI, as is in the Treaty) is the “Common Rules on Competition, Taxation and Approximation of laws”⁴⁴² More specifically, the Articles 90-93 relate to tax matters and it is evident that taxation is identified in them as a significant factor in the European integration process⁴⁴³.

Articles 90 to 92 of the Treaty⁴⁴⁴ specify the prohibition on any discriminatory taxation, either internal tax measure or in the form of excise duties or other levies, as well as prohibiting other types of protectionist measures for the Member State’s domestic products. For instance Article 90 was put in place as a preventative measure for Member States imposing higher internal taxes on imported products from another Member of the EU than the tax imposed on their own. These three articles do illustrate the idea at the time that EU should be an open market, imposing the European notion on commercial transactions at the same level or slightly above the national one. That is the reason why protectionist measures are not allowed either. These articles do press on the importance of a common European marketplace, trying to ensure a harmonized, to an essential basis at first, approach for all Member States. Also by not permitting a

⁴⁴² It includes Articles 81-97 of the ECT

⁴⁴³ Cecília Hargitai, 2001, Value Added Taxation of Electronic Supply of Services within the European Community, LL.M. Harvard Law School, Jean Monnet Working Paper 13/01

⁴⁴⁴ http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html

regime where each Member State is allowed to protect its domestic production, a more balanced arena is put in place, in an attempt to allow financially weaker Member States to compete on a level basis with the more financially strong ones.

Article 93⁴⁴⁵ established another rule relevant to the aspect of taxation and thus relevant to taxation of online transactions, with consideration towards a future framework in the area. It gave the competence of the Community to attempt harmonization of the national indirect tax regimes of the Member States. The fact that indirect taxes, for instance VAT, are charged on products and services, affects the flow of goods and services not within EU but on an international scale⁴⁴⁶. Article 93 presented a valuable insight in the EU's projected ability to intervene in the Member States' internal proceedings, more specifically in such a key area as taxation. However, there is a limit to the powers of article 93 to the extent that the harmonization must be necessary "to ensure the establishment and the proper functioning of the internal market".

⁴⁴⁵ http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html

⁴⁴⁶ Paul Craig & Grainne De Burca, 1998, EU Law, Oxford University Press, p49-95

Article 94 also suggests that Member States should be receiving legislation from the EU in the form of Directives⁴⁴⁷, providing the main targets and expected outcome.⁴⁴⁸ It is an efficient method of central regulatory framework encouraging harmonization to a certain desired degree, but it does allow a degree of autonomy to the Member States. This can result in a creating a compatibility regime, rather than absolute strict harmonization, as is evident from the indirect tax regime within the EU and its Member States⁴⁴⁹. That allows some degree of exercising their sovereignty over their national matters, which is very important as harmonization or further integration cannot take place if the participants are mainly passive actors. A relevant example of EU's objective towards a more homogenous tax regime is the VAT Directive 2006/112/EC⁴⁵⁰, where one of the basic rules provided that the rate of VAT charged on goods and services will be at least 15% amongst Member States, thus allowing the individual Countries to adjust it accordingly above the 15% minimum limit⁴⁵¹.

The references to specific provisions made so far reflect some of the legal instruments initially envisaged as relevant to the taxation within the European Community. The Treaty of Rome gives power to the Council to harmonise tax legislation, and sets certain

⁴⁴⁷ Art 249 ECT outlines the main legal instruments used by EU (Regulation, Directive, Decision, Recommendation, Opinion)

⁴⁴⁸ Article 94 ECT, http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf

⁴⁴⁹ Directive 77/388/EEC of 17 May 1977

⁴⁵⁰ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0112:20110101:EN:PDF>, (Official Journal L 347, 11.12.2006, p.1)

⁴⁵¹ Art 97, VAT Directive 2006/112/EC as amended by Council Directive 2010/88/EU of 7 December 2010

boundaries to the Member States' undertaking taxation procedures within their geographical boundaries or with other Member States. The EEC Treaty establishes the significant institutions and prescribes the system for decision-making. The vital institutions are the Council, the Commission and the European Parliament, which are meant to work together. While the Parliament plays more an advisory role to the other two, the Council prepares the standards and the Commission drafts the proposals. Another institution on a predominantly advisory post is the Economic and Social Committee⁴⁵².

2.1.2 The Maastricht Treaty

Another significant piece of primary legislation is the Treaty on European Union⁴⁵³. It was signed in Maastricht on 7 February 1992 and entered into force on 1 November 1993. 'The Maastricht Treaty changed the name of the European Economic Community to simply "the European Community" and it created a new structure with three "pillars"⁴⁵⁴. The original aim of the Treaty was to update the Treaty of Rome and set the stage for a common market, which materialised subsequent to the Treaty, and the

⁴⁵² <http://www.eesc.europa.eu/?i=portal.en.faq>

⁴⁵³ <http://eur-lex.europa.eu/en/treaties/dat/11992M/htm/11992M.html>

⁴⁵⁴ The Maastricht Treaty creates the European Union, which consists of three pillars: the European Communities, common foreign and security policy and police and judicial cooperation in criminal matters.

result was Economic and Monetary Union (EMU)⁴⁵⁵. The Treaty intended to constitute the circumstances ready for further European integration of all Member States. An article within the Treaty of particular relevance is Article 6⁴⁵⁶, which states that human rights and fundamental freedoms shall be respected and not infringed or discriminated against. At the time it was a novel concept to place taxation next to human rights⁴⁵⁷, directing the discussion⁴⁵⁸ around themes such as how tax avoidance infringes human rights and how tax system design can assist with the delivery of human rights in a tangible format.

2.1.3 Institutions

One of the main elements to tax regulation is the structure of the Institutional Framework of the European Union⁴⁵⁹. These institutions are the European Court of Justice, the European Parliament, the Commission, the European Council and the Council of Ministers. The European Council is not as influential as the other bodies are,

⁴⁵⁵ http://ec.europa.eu/economy_finance/euro/emu/index_en.htm

⁴⁵⁶ Article F – EUT

1. *The Union shall respect the national identities of its Member States, whose systems of government are founded on the principles of democracy.*

2. *The Union shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms signed in Rome on 4 November 1950 and as they result from the constitutional traditions common to the Member States, as general principles of Community law.*

3. *The Union shall provide itself with the means necessary to attain its objectives and carry through its policies.* (<http://eur-lex.europa.eu/en/treaties/dat/11992M/htm/11992M.html>)

⁴⁵⁷ Lamb, Lymer, Freedman, James (ed), 2005, “Taxation: An interdisciplinary Approach to Research”, OUP

⁴⁵⁸ An example of taxation having a potential effect on human rights, can be seen in the Parliamentary discussion relating retrospective taxation, www.parliament.uk/briefing-papers/SN04369.pdf, July 2012

⁴⁵⁹ Functions and Powers of the EU (former EC) Institutions is described in Part Five of the ECT (Articles 189-267)

when it comes to the legislative aspect, but its role is designated towards political interventions. When considering the legislative aspect, a very important role is played by the Council of Ministers⁴⁶⁰. The institution with a rather extended scope of more than one function within the EU is the European Commission⁴⁶¹. Most of the legislative powers are delegated by the Council, which also has responsibility for initiating legislation (after delegated by Council usually), enforcing regulation/legislation, as well as acting in the role of mediator. The Commission is a “key player in the introduction, drafting, negotiation, and design of the final legislative product”⁴⁶². Its role is to pass delegated legislation, and, as referred to earlier, it is responsible for enforcement of EU law, and thus can take measures, such as infringement procedures, against MS failing to adhere to it.

The European Court of Justice is as vital to the EU as the Commission is. More specifically to taxation, ECJ is the one supporting any taxation regulation proposals and directives and promoting them to the MS, who in turn can adopt the new legislation. Under the TFEU⁴⁶³ Member States have accepted that part of their powers has been

⁴⁶⁰ The composition of the Council is also referred to as “ECOFIN” and it comprises of ministers from national governments, who have the fiscal responsibilities

⁴⁶¹ The only body authorised to present proposals for legislation. Alongside, the Economic Social Committee and the European Parliament consider the proposals and consult third parties to ensure functionality and any errors.

⁴⁶² Lamb, Lymer, Freedman, James (ed), 2005, “Taxation: An interdisciplinary Approach to Research”, OUP, p.219

⁴⁶³ Treaty on the Functioning of the European Union 2012/C 326/01

transferred to the EU and its institutions.⁴⁶⁴ Interpretation and application of EU law is the main focus of the ECJ. In relation to tax, the ECJ will identify the necessity and by implication or suggestion direct the MS to alter their national legislation framework relating to tax.

An example of that can be seen in the case of *Shumacker*⁴⁶⁵, where a frontier worker had to pay more tax in Germany because he was not a resident. ECJ needed to interfere in order to assist EU law to create a clearer distinction between resident and non-resident taxpayers⁴⁶⁶. The reason for that specific interference was that the aforementioned distinction has implications for the relevant tax authorities towards a person's discriminatory treatment, based on nationality or professional status dependent on the state of residence. ECJ also received assistance by the Advocate General, who has the role to provide an independent and impartial Opinion to the ECJ⁴⁶⁷. So it is obvious that ECJ plays and will keep playing an important role in the area of taxation within EU, and since the *Costa*⁴⁶⁸ case, it was highlighted that EU law must always be taken in consideration before any MS attempts to legislate. The reason for

⁴⁶⁴ *Costa v ENEL* [1964] ECR 585, Case 6/64,

⁴⁶⁵ Case Schumacker, C-279/93, http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61993J0279

⁴⁶⁶ International tax law has a clear distinction between resident taxpayers, who are taxed for any income they have around the world, and non-resident taxpayers, who are taxed in a base state for the income they make there.

⁴⁶⁷ *Trinity Mirror Plc (formerly Mirror Group Newspapers Ltd) v Customs and Excise Comrs* [2001] EWCA Civ. 65, Judgement of Chadwick L.J

⁴⁶⁸ *Costa v ENEL* [1964] ECJ, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61964J0006:EN:NOT>

that is to avoid law making contrary to what EU law prescribes, even though the final word lies with the National court.⁴⁶⁹ The ECJ has assisted and allowed significant development, specifically in the area of EU tax initiatives and in the area of cross-border tax and national systems operation⁴⁷⁰, but it would be interesting to consider the extent of jurisdiction it could have in a more unified and harmonized tax regime across the Member States⁴⁷¹.

The European Commission and the European Court of Justice are the main actors in this area, with the European Parliament and the Economic and Social Committee⁴⁷² having an advisory role, mainly. The EU VAT Committee was set up under the 6th VAT Directive, and its role is to provide advice and recommendations for policy related matters on VAT-related issues⁴⁷³. It was established to encourage uniformity in the implementation process of Vat related provisions from all involved Member States. In cases of non-compliance, the Court of Justice of the European Communities⁴⁷⁴ is the institution to intervene and overlook at the circumstances of non-compliance as well as examining the legality of the acts taken by the Commission and the Council.

⁴⁶⁹ Art 267 TFEU – the functions of the ECJ and those of the referring national court are clearly separate, and it falls exclusively to the latter to interpret national legislation. Also, Case C-253/03) CLT-UFA SA v Finanzamt ECR Case I-1831.

⁴⁷⁰ Hanns-Martin Bachmann v Belgian State [1992] ECR I-249, [1992] EUECJ C-204/90, Jessica Safir v Skattemyndigheten i Dalarnas Län, formerly Skattemyndigheten i Kopparbergs Län [1998] ECR I-1897 MN 35;

⁴⁷¹ Commission presented some suggestions on this matter in COM (2001) 260 Final

⁴⁷² Its membership comprises or employers, employees and other interest groups.

⁴⁷³ http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/vat_committee/index_en.htm

⁴⁷⁴ http://europa.eu/about-eu/institutions-bodies/court-justice/index_en.htm

Also, there is a set of mechanisms, not institutions but operating within the, which give EU the authority to establish specific legislation frameworks. EU does have the authority to impose legislation only on issues directly relevant to the Treaties.⁴⁷⁵ All matters not directly referred to in the Treaties are within the discretion of the Member State. However two principles, the “subsidiarity” and the “proportionality” principles, do give EU the scope of taking action when specific circumstances arise. The first one will allow EU to take specific action if the MS would not be able to achieve a sufficiently efficient and adequate action⁴⁷⁶. Of course, for the EU to take action there is always the need to only go as far as is necessary regarding the Treaties’ provisions, as specified under the proportionality principle⁴⁷⁷. These two principles appear to be significant in the specific relation of electronic commerce and taxation especially considering that EU’s relevant regulatory attempts are in the form of Directives⁴⁷⁸. The two aforementioned principles could give the standing for EU to take proposed action in case the MS are not sufficiently equipped or the administration is failing to take the necessary steps as directed by the Union, which appears to be imperative for the neuralgic field of taxing electronic commerce.

⁴⁷⁵ Art 5 TEU

⁴⁷⁶ Art 5 TFEU

⁴⁷⁷ Art 5 TEU, The criteria for applying it is set out in the Protocol (No 2) on the application of the principles of subsidiarity and proportionality annexed to the Treaties.

⁴⁷⁸ http://ec.europa.eu/eu_law/introduction/what_directive_en.htm

2.2 6th VAT Directive⁴⁷⁹

The ECT and the Maastricht Treaty were mentioned previously in order to provide the background for the first relevant to taxation legislative efforts within the EU. However, the specific principles of VAT were debated and introduced in the 1960's, by the recommendations of a Fiscal and Financial Committee, which comprised of officials from National Governments and experts from the Commission⁴⁸⁰. The First VAT Directive (Dir. 67/227) was presented in 1967, basically asking the MS to implement a common VAT system. A Second Directive (Dir. 67/228) was also put in place to add some specific details on certain matters, but 10 years later it was revoked by the Sixth VAT Directive⁴⁸¹. The Sixth Directive (77/388) was put in place to amend certain inadequacies of the First and Second; MS wanted a greater degree of flexibility, and a system which would identify each country's proper and equitable tax base. With the 6th VAY Directive *"EU is abolishing tax controls at internal frontiers for all transactions carried out between Member States, approximating the value-added tax (VAT) rates applicable to those transactions and making provision for a transitional phase of limited duration that*

⁴⁷⁹ After 2007 referred to as the VAT Directive

⁴⁸⁰ AJ Easson, 1980, "Tax Law & Policy in the EEC", Sweet & Maxwell

⁴⁸¹ Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment. <http://europa.eu/scadplus/leg/en/lvb/l31006.htm>

will ease the transition to the definitive arrangements for the taxation of trade between Member States”⁴⁸². There have been 20 amendments to the 6th Directive so far⁴⁸³.

The 6th Directive is the main part of the EU VAT law, and that can be seen by the fact that the ECJ relies upon its provisions heavily. ECJ in some cases has held that since the provisions of the 6th Directive are so clear and precise, individuals in EU MS can rely upon them, even against national tax provisions⁴⁸⁴. There have also been instances where national courts may need to ask for reference to the ECJ, even if the taxpayer has not asked for it⁴⁸⁵. Within Europe, the basic taxation framework related to VAT is also based significantly on the 6th Directive. But it doesn't provide for everything and one of the main areas it doesn't cover is the rules regarding the procedural functionality of VAT, which leaves a task for the MS to cover. But in the *Marks and Spencer plc. v CEC* (2002), ECJ held that “1) the fact that a directive has been properly implemented does not affect an individual's right to ensure full application of the rights conferred under it, provided they are sufficiently precise and unconditional, 2) whilst the rules for collection and repayment of overpaid tax were a matter for domestic law, the general principles of Community law would be applied to them.

⁴⁸² <http://europa.eu/scadplus/leg/en/lvb/l31006.htm>

⁴⁸³ Stephen Bill, 2004, “The VAT strategy” (1/05/2004)
http://ec.europa.eu/taxation_customs/resources/documents/article_on_vat_strategy-en.pdf

⁴⁸⁴ One example of such a case is *Fizanzamt Munchen III v Mosche* (1997)

⁴⁸⁵ *Fazenda Publica v Camara Municipal do Porto* (2001)

To what extent was the VAT Directive relevant to electronic commerce? The VAT Directive was originally put in place to shape the area of VAT policy within the European Union marketplace and establish a more homogenous taxation framework. Electronic commerce presented some challenges to achieving that homogeneity and VAT Directive assisted in identifying the areas needing attention and potential amendments to the Directive's provision. In an Explanatory Memorandum in relation to amendments to the 6th VAT Directive, the Commission's aim was summarised as '*The Commission's intention is that the proposal should give electronic commerce operators a clear framework in which to charge, collect and remit VAT on electronic deliveries*'.⁴⁸⁶ The main reason for the proposed amendments was to attempt adequate addressing of the aspect of direct electronic commerce and its tax implications. Looking at direct electronic commerce, the focus of the VAT policy is on the cross-border transactions involving digitised goods or services, putting emphasis on the final consumer and their location within the EU.⁴⁸⁷ The VAT Directive and its provisions also brought about the discussion on whether traditional commerce and electronic commerce could use the same VAT framework, and

⁴⁸⁶ Commission of the European Community, Explanatory Memorandum to the Proposal for a Council Directive amending the Sixth Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means (COM (2000) 349 final) June 7, 2000 ('the Explanatory Memorandum').

⁴⁸⁷ In particular article 9(2) incorporated electronic services as well as a new Annex L was added to illustrate these services.

http://webarchive.nationalarchives.gov.uk/20120128212010/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_PublicNoticesAndInfoSheets&propertyType=document&columns=1&id=HMCE_CL_000907

whether that could be done in an efficient manner.⁴⁸⁸ Electronic commerce was considered as a pioneering platform that could change the way in which people buy and sell things, and the Commission indicated that at some point in the future there may be necessity for '*a full scale review of the exiting VAT*' because of the perceived then complexity of online commercial environment.⁴⁸⁹

2.2.1 2004 update

On February 2004, a new article 29a of the Sixth EU VAT Directive entered into force to ensure a more standardized application of the current EU VAT system. The reason was because even though the EU VAT system has had a common framework, which is dictated by the Sixth EU VAT Directive to a great extent, each of the MS still has the duty to implement and apply this common frameset into its own national legislation, and as it can be the case EU Member States may have different approaches and interpretations on specific provisions of the 6th Directive⁴⁹⁰. That can potentially present a problem for electronic commerce if each Member State adopted different approaches to VAT, therefore different approaches to VAT treatment in the electronic commerce context;

⁴⁸⁸ Interim Report on the implications of electronic commerce for VAT and Customs, DG XXI working paper XXI/98/0359 of 3 April, 1998

⁴⁸⁹ Commission of the European Community, Explanatory Memorandum to the Proposal for a Council Directive amending the Sixth Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means (COM (2000) 349 final) June 7, 2000 ('the Explanatory Memorandum').

⁴⁹⁰ Lejeune & Mesdom, 2006, "The shape of things to come? Significance of new EU implementing Regulation", 2006, Tax Planning International

for instance, a Member State could take certain measures as regards the determination of the person liable for payment of VAT, something which could impact on the vendors of online services as well⁴⁹¹. In order to avoid disparity and failure to implement, a mechanism was necessary to be put in place.

Article 29a and the measures taken, were trying to ensure compatibility and to an extent harmonisation and avoid potential future conflicting jurisdictions or even double-taxation occurrences. One has to be careful though, as these regulations are not to amend the 6th Directive, but simply to assist in the proper comprehension and implementation of it. Regulation (EC) No 1777/2005 of 17 October 2005, published in the Official Journal of 29 October 2005 (L 288/1), is the first Regulation based on article 29a. It comprises of decisions of the EU VAT Committee regarding the interpretation of the Sixth EU VAT Directive. The EU VAT Committee⁴⁹² is a body holding technical discussions about EU VAT⁴⁹³. Maybe the EU could follow on the effectiveness of Article 29a and in similar circumstances make similar implementation of regulatory mechanisms to assist Member States; it speeds up the procedure and doesn't take

⁴⁹¹ Directive 2000/65/EC amends Directive 77/388/EEC as regards the determination of the person liable for payment of VAT.

⁴⁹² The EU VAT Committee is presided by the EU Commission and all EU Member States are represented. Contrary to decisions or guidelines of the EU VAT Committee, a Regulation is binding for Member States and for taxable persons.

⁴⁹³ Lejeune & Mesdom, 2006, "The shape of things to come? Significance of new EU implementing Regulation", Tax Planning International

matters to more unnecessary consultation, since that would have been dealt with from the EU VAT Committee.

So far, the discussion concentrated on the Institutional Framework in place to ensure the taxation system operates efficiently within the EU, as well as looking into the historic background on the development of VAT through the initial attempts to regulate, up until the 6th VAT Directive (and all the subsequent amendments). Before moving on to examine more contemporary legislation, a brief note on the current system in EU for offline and online sales will be made. In general, transactions are subject to VAT within the member country, within the EU (intra-community) and when imported from outside of the EU (cross-border).

In addition, the EU-VAT rules are operating on a dichotomy of goods and services (tangible or intangible goods) and evaluate whether transactions are performed for business customers or private customers (B2B and B2C)⁴⁹⁴. Currently for B2B supplies of goods intra-Community supplies are exempted from tax, and the tax is paid by the recipient in the MS of destination.⁴⁹⁵ In any situation where goods are purchased

⁴⁹⁴ Doernberg, R.L., Hinnekens, L., Hellerstein, W. & Li, J. 2001, *Electronic Commerce and Multijurisdictional Taxation*, Kluwer Law International, The Hague, p. 99.

⁴⁹⁵ Stephen Bill, 2004, "Future changes to the 6th VAT Directive" (1/06/2004), http://ec.europa.eu/taxation_customs/resources/documents/article_on_future_changes_of_sixth_vat_directive-en.pdf

electronically, but are actually tangible goods which are subsequently delivered in a traditional manner, the VAT implications are no different to any other form of sales, simply like purchasing a book in a bookshop in the High Street. When goods are intangible and the transaction is regarding online purchase and online delivery of the service/good, then, as seen in the earlier chapter on challenges of taxing electronic commerce, complexity arises. The transaction needs to be identified and characterised with accuracy; tangible good or service need to be established as the subject matter of the transaction. Also, the location of consumption must be flagged up, for VAT collection purposes, and that alone can be problematic as to an extent anonymity can be ensured online.⁴⁹⁶

2.2.2 Paving the way ahead?

European Union's taxation system has developed a regulatory framework in accordance with the guidelines produced by OECD⁴⁹⁷. Basically, the Ottawa principles tried to establish that consumption taxes should be levied where the consumption occurs, as well as that there should be a simple registration scheme for non-resident, in this case non-EU traders. Each Member-State charges VAT at rates dependent on the country's

⁴⁹⁶ Giampaolo Bella, Rosario Giustolisi, Salvatore Riccobene, 2011, Enforcing privacy in electronic commerce by balancing anonymity and trust, *Computers & Security*, Volume 30, Issue 8, Pages 705-718, (<http://www.sciencedirect.com/science/article/pii/S0167404811001052>)

⁴⁹⁷ Ottawa Principles are discussed in detail later

legislation and fiscal rules.⁴⁹⁸ It has been seen as the aim of fulfilling the target of Single Market to have a harmonised VAT system for all Member States⁴⁹⁹. Currently there is the standard VAT rate for all Member States and there is the optional rates for certain specified goods⁵⁰⁰. A fully coordinated scheme would perhaps allow fading out any differences in tax systems within a Union of Member-States, ensuring higher compliance from inter-state vendors, and potentially achieve a more stable taxation framework.

As will be discussed in more detail below, the Electronic commerce VAT Directive was introduced to establish simplified procedures regarding taxing of electronic commerce activities. The place of consumption was identified as the place of supply and where the levy is to be charged, applying these rules to non-EU suppliers as well and, also putting in place simplified procedures of registration for vendors. Overall the Commission's purpose with the Electronic commerce VAT Directive was to improve and update on the 6th VAT Directive in respect to taxation of online transactions and especially the intangible nature of the service. Overall, the EU system has been seen as an effective one amongst the Member States⁵⁰¹, and it should be taken into consideration for

⁴⁹⁸ GJH Smith, 2007, "Internet and Regulation", 4th edition, Sweet & Maxwell

⁴⁹⁹ Seely 2013, Briefing Paper - VAT:European law on VAT rates, <http://www.parliament.uk/briefing-papers/sn02683.pdf> (August 2013)

⁵⁰⁰ Annex III to VAT Directive 2006/112/EC

⁵⁰¹ Hellerstein W. And Gillis T. H. 2010, The VAT in the European Union, Tax Analysts 2010, <http://taxprof.typepad.com/files/127tn0461.pdf>

further design of VAT regimes, especially those directed to electronic commerce⁵⁰². The last suggestion could be taken into consideration in jurisdictions with no development of VAT regime, especially the other big “actor” in the electronic commerce platform, the US.

2.3 Current initiatives

The European Commission on the 7th May 2002 confirmed the adoption of a Directive to amend the VAT legislation, applicable at the time. The Directive came into effect on 1st July 2003 and introduced some amendments to the system of VAT for online transactions. A major change is the requirement for non-E.U. resident vendors to apply VAT when selling digital goods and services in the EU. The objective of Directive 2002/38/EC is to create a level playing field for EU businesses and minimize or eliminate the unfair competitive advantage enjoyed by non-EU traders. It also aims to make the compliance of non-EU vendors easy and uncomplicated in the altered tax system for online transactions.

⁵⁰² OECD, 2004, “Report: the application of consumption taxes to the trade in International Services and intangibles” 4 (CTPA/CFA (2004) 34)

The Directive, which came into effect from 1st July 2003, requires non-E.U. resident vendors to apply VAT when selling “digital goods” in the EU. The new Directive is supposed to address and eliminate the above mentioned⁶⁵ unfair competitive advantage enjoyed by non-EU traders. This system is to be applied for three years following implementation of the proposal and could then be extended or revised.

In 1997 the European Commission made one of the first statements on the future of the EU’s VAT system when the Commission started to examine the tax implications of electronic commerce.⁵⁰³ In April 1998 the Directorate General for VAT and Customs was able to produce an Interim Report.⁵⁰⁴ This report highlighted mainly three conclusions. First, the existing system of indirect taxation was the best way to approach the fiscal challenges of electronic commerce and thus the Commission decided not to establish any new methods of taxation or amend the legal base of the 6th Directive and recommended that the existing system would be sufficient to ensure collection of taxes.⁵⁰⁵ The second is that it was designed in order to minimize complexities and simplify the rules of custom clearance of small volume imports of goods. The third and final conclusion was the report’s suggestion of the immediate need for a VAT rule, in order to protect tax base for direct electronic commerce. The overall proposal was for

⁵⁰³ Basu, 2007, Global perspective on Electronic commerce Taxation Law, Ashgate, p211

⁵⁰⁴ DG XXI, Interim Report 98/0359 of the 3rd April 1998, http://europa.eu.int/comm/dgs/taxation_customs/

⁵⁰⁵ Basu, “European VAT on Digital Sales”, The Journal of Information, Law and Technology (JILT) 2002 (3) http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_3/basu/

an adjustment of the VAT legislative base to incorporate the new principles, and more efficiently implement control and enforcement monitoring. Also, the need for international effort to solve the problem was addressed as a necessity, and since then the EU has worked closely with OECD, to tackle these concerns.

A proposal for a Directive was put on the table on June 7, 2000, by the European Commission;⁵⁰⁶ the purpose was to amend the rules for applying VAT to certain services supplied by electronic means. The Commission proposed to amend the EU VAT system for electronic commerce operators by specifically amending sections 9, 12, 24, 28g and 28h of the Sixth Directive. “The Commission’s intention is that the Proposal should give electronic commerce operators a clear framework in which to charge, collect and remit VAT on electronic deliveries”⁵⁰⁷ This proposal⁵⁰⁸ was an initial effort to provide a realistic solution to the challenges examined in 1997⁵⁰⁹. It also contradicted the numerous statements by the Commission up to that date, most of them stating that radical changes would not be needed for the EU VAT system, as well as the statement that

⁵⁰⁶ European Commission, “Explanatory Memorandum to the Proposal for a Council Directive amending the Sixth Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means, June 7th of 2000

⁵⁰⁷ Commissions of the European Community, Explanatory Memorandum to the Proposal for a Council Directive amending the Sixth Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means (COM (2000) 349 final) June 7, 2000 (“the explanatory memorandum”)

⁵⁰⁸ For a better account of the 7th of June 2000 Proposal, please refer to the publication of Basu, op cit

⁵⁰⁹ European Commission, “Explanatory Memorandum to the Proposal for a Council Directive amending the Sixth Directive as regards the value added tax arrangements applicable to certain services supplied by electronic means, June 7th of 2000

electronic commerce would be using the same VAT framework.⁵¹⁰ The June 7th Proposal failed to get enough support amongst the Member States. This in turn forced the Commission to favour the February 2002 proposal, even though many of the rules had actually already been implemented by the 2000 Proposal.⁵¹¹

2.3.1 Directive 2002/38/EC

Unlike the previous Proposal, in 2002 the Council concurred on the new regulatory framework for VAT on electronic commerce.⁵¹² The European Commissioner for Taxation in 2002, Frits Bolkenstein, argued that legislation will manage to satisfy everyone involved in the market and affected by the changes. He said “I welcome the decisions of the council to adopt these rules on applying VAT to digital products. They will remove the serious competitive handicap which EU firms currently face in comparison with non-EU suppliers of digital services, both when exporting to world markets and when selling to European consumers”⁵¹³. On the 12th of February 2002 the Council agreed to new rules regulating the VAT on electronic commerce. At the same time, another significant Regulation was adopted, Council Regulation (EC) 792/2002,

⁵¹⁰ Basu, European VAT on Digital Sales

⁵¹¹ Basu, Global perspective on Electronic commerce Taxation Law, p221 (see about UK’s blocking of the 200 Proposal)

⁵¹² Proposal was formally adopted on 7th May 2002, after the Proposal was translated in all 11 EU working languages.

⁵¹³ Reuters (2002) “Europe Approves Net Tax Law”, May 7, www.wired.com/news/print/0,1294,53351,00.html

temporarily amending Regulation 218/92 relating to administrative co-operation in the field of indirect taxation to introduce new measures essential for the registration of non-EU online traders for VAT purposes and for distributing the VAT receipts to the member states.⁵¹⁴

The Council Directive 2002/38/EC⁵¹⁵ on the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services took effect on 1st July 2003. The Directive was extended to the 31st December 2008, in order not to revert back to the previous regulations and allow time for more careful examination of the area. Does the current legislation qualify for a permanent status? The purpose of the new legislation was to ensure that electronic commerce would not be halted by more regulation and conventional commerce would not be brought to a standstill from inadequate regulation, neutrality was to be ensured. Under the new Directive, the VAT is not charged at the place of supply, but at the place of consumption. This change eliminated the major difference between EU and non-EU vendors, in favour of the EU ones. Consequently that created a lot of criticism and raised the issues by the different perspectives, main one being from the US.

⁵¹⁴ www.europa.eu.int/comm/taxation_customs/taxation/ecommerce/vat_en.htm

⁵¹⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:128:0041:0044:en:PDF>

The Directive can be divided into three sets of provisions. First one is the redefinition of the place of supply rules for electronic deliveries. Second one is the revision of administrative provisions which are essential to implement the redefined rules. Also, a set of conditions is included to assist compliance of operators providing e-services, not established or identified within EU, with their tax obligations. In addition, the Directive contains a set of regulations to help discharge VAT obligation by electronic means.⁵¹⁶ Under the 2002 Directive, electronically delivered services are taxable at the customer's location. Non-EU vendors will have to charge VAT on sales to private consumers, similarly to what EU vendors do. There is a requirement for non-EU traders to register with tax authorities in any EU Member State, and levy VAT at the rate relevant to the customer's residence country.⁵¹⁷ The country of registration (non-EU suppliers had to be registered by July 2003) reallocates the VAT revenue to the country of the customer.⁵¹⁸

It is worth noting here that EU considers all products that are electronically delivered as services. Annex L gives a few examples of these services: Web site supply, web hosting, distance maintenance of programs and equipment; Supply of software and updating

⁵¹⁶ Basu, European VAT on Digital Sales, *The Journal of Information, Law and Technology* (JILT) 2002 (3) http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_3/basu/

⁵¹⁷ www.europa.eu.int/comm/taxation_customs/taxation/ecommerce/vat_en.htm

⁵¹⁸ The new rules are not applicable for sales by non-E.U. companies to European business buyers. For these transactions VAT is already imposed on purchases. Therefore these rules remain unchanged and the reverse charge mechanism will guarantee the collection of VAT.

thereof; Supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events; Supply of distant teaching; Radio or television broadcasting services solely broadcast over the Internet or a similar electronic network. Still no tax will be collected on free downloads or free access to the Internet. In the cases where the Internet is only used as a communication channel between supplier and customer, there would be no change.⁵¹⁹

Article 1 of the Directive states that the Directive 77/388/EC is temporarily amended as follows: In Art. 9 (2) (e) the following indents shall be added:

- “radio and television broadcasting services,

Electronically supplied services, inter alias, those described in Annex L.”

In Art.1 reads the new rule of supply by adding to Art.9 (2) point (f).⁵²⁰ It is evident that EU aims to address the taxable persons, who are the non-EU suppliers of services to

⁵¹⁹ Basu, European VAT on Digital Sales, The Journal of Information, Law and Technology (JILT) 2002 (3) http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_3/basu/

⁵²⁰ Furthermore in Art. 9 (2), the following point (f) is added:

“(f)...the place where services referred to in the last indent of subparagraph (e) are supplied; when performed for **non-taxable persons** who are established, have their permanent address or usually **reside in a Member State, by a taxable person** who has established his business or has a fixed establishment from which the service is supplied **outside the Community** or, in the absence of such a place of business or fixed establishment, has his permanent

non-taxable persons within EU; in that case the place of supply is to be the established place of the non-taxable. By this new regulation related to the supply, the aim is to remove the disadvantage of EU-traders compared to non-EU ones, when services were sold to EU private customers. By altering the rules of supply, EU became a pioneer tax jurisdiction to develop and employ a framework for consumption taxes on electronic commerce, following the Guidelines of the Ottawa Framework⁵²¹.

As mentioned above alongside the new rule of supply, the Directive implemented a special system for services supplied electronically; it is regulated in the new Article 26c and shall only apply to all those supplies within the Community.⁵²² Pursuant to Article 26c non-E.U. suppliers are permitted to register in a single Member State, but they have to be able to account for VAT in all of the E.U. Member States in which they supplied a final consumer.⁵²³ To make the new system easier to implement, non-EU suppliers face a simplified online registration and compliance mechanism, which lets them fulfil their VAT duties without being physically present.⁵²⁴

address or usually resides outside the Community, **shall be the place where the non-taxable person is established**, has his permanent address or usually resides.”

⁵²¹ TAXATION FRAMEWORK CONDITIONS – OECD, 1998, <http://www.oecd.org/dataoecd/46/3/1923256.pdf> (December 2010)

⁵²² Art. 26c B 1

⁵²³ Siliakis, "Taxation of Electronic commerce: a Task for Jugglers." Masaryk UJL & Tech. 1 (2007): 141.

⁵²⁴ Fairpo, "VAT and Electronic commerce", June 16, 2002

Looking at Article 26c B 2, it reads as follows:

“The non-established taxable person shall state to the Member State of identification when his activity as a taxable person commences, ceases or changes to the extent that he no longer qualifies for the special scheme. Such a statement shall be made electronically.”

The registration means they need to provide substantial documentation/information (name, postal and e-address, web sites, national tax number, and a statement that the trader has not already been registered for VAT within EU). An email providing a dedicated number will be sent to the supplier by the tax authority they chose⁵²⁵, to which the supplier must provide, within 20 days following the end of the reporting period in reference, a quarterly VAT return (detailing total value of sales and tax collected in each Member State)⁵²⁶ and the return will be made in Euros.⁵²⁷ Records must be kept for 10 years⁵²⁸ and made available electronically on request to Member State of identification and the one of consumption in order for the tax authorities to determine the correctness in VAT return.⁵²⁹ Tax will then be remitted to the relevant tax

⁵²⁵ Art. 26c B 3

⁵²⁶ Art. 26c B 5

⁵²⁷ Art. 26c B 6

⁵²⁸ Art. 26c B 9

⁵²⁹ Art. 26c B 9

authority by the supplier, and that authority will reallocate the VAT revenues among the other MS.

One shortcoming of the Directive is the lack of penalties for non-registering; registration is a duty according to the Directive but if non-EU companies do not register they cannot be held liable. The 2000 Proposal had a threshold for registration for non-EU sellers if the sales exceeded 100.000 Euros; no obligation to comply if EU sales less than that.⁵³⁰ In the 2002 Directive there is no threshold, which leaves registration with no exact threshold, which could mean all non-EU vendors need to register irrespective of their sales profits.

2.3.2 Other relevant developments

In 2002, the Directive 2002/38/EC was not the only important legislative measure introduced by the EU. The Regulation (EC) 792/2002,⁵³¹ which introduces methods to register non-EU e-service traders for VAT purposes. The Regulation establishes the obligations for the Member States and the approach on the way to distribute collected tax. According to the Regulation the Member State of identification is obliged to provide

⁵³⁰ Hardesty, "European VAT on Digital Sales", March 2002, www.ecommercetax.com

⁵³¹ Official Journal of the European Communities, (2002), "Council Regulation (EC) 792/2002, temporarily amending the Regulation (EEC) 218/92 on administrative co-operation in the field of indirect taxation", L128/1 (15.5.2002)

electronically any information relating to registration to all other Member States within ten days after the end of the month of registration.⁵³² The reason for this obligation is to ensure all Member States can have access to the registration information of the non-established seller. Similar approach is taken regarding submitted VAT returns; the timeframe is for 10 days after the end of the month of filing the VAT return, the Member State of identification has to electronically provide all other Member States with the tax return.⁵³³ The tax authorities of the Member State of identification hold the responsibility for reallocating the VAT revenues among the other Member States.⁵³⁴

The above mentioned modified rules and regulations by the European Union mean that EU suppliers are not required any more to charge tax when trading outside EU, a development to improve the competition scale between EU and non-EU traders. Non-EU traders have to adhere and operate their business on the same VAT rules as the EU companies⁵³⁵. By Council Directive 2006/58/EC, adopted on 27th June 2006, the above VAT arrangements were extended up to December 2006.⁵³⁶ On May 2006 the period of

⁵³² Art 9b (2) Council Regulation EC 797/2002

⁵³³ Art 9c Council Regulation EC 797/2002

⁵³⁴ Art 9f Council Regulation EC 797/2002

⁵³⁵ But a note is to be made here that this changes are only for B2C transactions. In B2B transactions the VAT will still be remunerated by the business who imports the products/services

⁵³⁶ Council Directive 2006/58/EC of 27 June 2006 amending Council Directive 2002/38/EC as regards the period to a further 6 months to December 2006 (Basu, Global perspective on Electronic commerce Taxation Law, p227)

the Directive's application was extended to December 2008.⁵³⁷ Laszlo Kovacs, the Taxation Commissioner, advised "the EU Council of Ministers to rapidly reach an agreement on this extension as I cannot imagine we would revert to the rules prevailing before the electronic commerce Directive was introduced".⁵³⁸ "I also request support from the EU Council to adopt as soon as possible the two Proposals on the place of taxation of services and on the One Stop VAT Shop scheme⁵³⁹, which will in essence give permanent effect to the measures in the electronic commerce VAT Directive"⁵⁴⁰

The "one-stop shop" mechanism has been introduced for services provided through electronic means and it is a significant new step in the development and functionality of the VAT. The Council, for the first time, has accepted the principle that the Member State where a transaction is taxed does not have to be necessarily the Member State in which the VAT obligations relating to the transaction have to be fulfilled⁵⁴¹. Because the Council is attempting to make the procedure simpler, it has been agreed that a non-EU established seller, will be identified, arrange his tax returns and VAT payment (on all the electronic supplied services that seller provides to non-taxable persons in the EU) in one

⁵³⁷ A report to the Council for operation of COUNCIL Directive 2006/58/EC of 27 June 2006 amending Council Directive 2002/38/EC as regards the period of application of the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services.

⁵³⁸ Basu, Global perspective on Electronic commerce Taxation Law, p228

⁵³⁹

⁵⁴⁰ Basu, op cit (n.68)

⁵⁴¹ "Future changes to the 6th VAT Directive" by Mr Stephen Bill, Head of the VAT and other turnover taxes unit, 1/06/2004, http://ec.europa.eu/taxation_customs/resources/documents/article_on_future_changes_of_sixth_vat_directive-en.pdf

single place, the “one-stop shop”. If that can happen for the non-EU sellers, it should be done for the EU-sellers too; puts them both on the same level regarding compliance effort and requirements. Therefore, if the “one-stop shop” can be developed fully and directed to both categories of sellers, EU and non-EU, it could simplify obligations for both, and thus improving the compliance levels⁵⁴².

The findings of the Commission were that the VAT Directive has been efficient and achieved the main objectives, thus creating a more balanced playing field taxing electronic commerce transactions. The recommendation is for the period of application to be more permanent, and to be cautious because in the case these rules did not get extended in time, then the VAT scheme would have to revert to the one before the 2002/38 Directive.⁵⁴³ Subsequently, after the extension, Directive 2008/8/EC reads that the rules introduced by the Directive 2002/38/EC are extended from 1st January 2010 as a permanent measure⁵⁴⁴.

⁵⁴² A similar proposal is debated in the USA. See <http://www.streamlinedsalestax.org>

⁵⁴³ The temporary provisions contained in the Directive will be given permanent effect when the EU Council of Ministers adopts the Proposal from the Commission’s on the place of taxation of services (COM (2005) 334; see IP/05/997) and on the simplification of VAT obligations (the proposal for “One Stop VAT Shop”; COM (2004) 728; see IP/04/1331). The extension proposed should allow sufficient time for the adoption of these proposals.

⁵⁴⁴ http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/index_en.htm

In addition to the ones mentioned so far, two more relevant Directives were adopted by the EU Council of Ministers, on the 12th February 2008; one is on the place of supply of services, and the other on VAT refunds. With the two new Directives, more certainty is placed on taxing services at the place of consumption, in the country of consumption, and new procedures will be established for claiming VAT receipts to achieve quicker processing⁵⁴⁵. Starting from 1st January 2010, B2B supply of services will be taxed at the location of the customer, not the seller as was previously, but on the other hand, B2C services supply will be taxed where the seller is established. But that will not be the case for all transactions; there are exceptions and specific rules will be applicable to them, for instance scientific and educational services as well as electronic services and telecommunications are going to be taxed at the place of consumption. Also, MS will all need to employ an electronic procedure for VAT reimbursement, ensuring speed and certainty for businesses.⁵⁴⁶ László Kovács, Commissioner responsible for Taxation and Customs said: "I am content that the change in the rules on the place of supply of services will ensure a more even playing field for businesses supplying services throughout the Community. This is particularly true of services which can be supplied at a distance where, as a result of current rules, businesses have been locating in countries

⁵⁴⁵

http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/legislation_recently_adopted/index_en.htm

⁵⁴⁶ See the press release (IP/08/208) (VAT package: Commission welcomes adoption by the ECOFIN Council of new rules on the place of supply of services and a new procedure for VAT refunds -
Reference: IP/08/208 Date: 12/02/2008)

<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/208&format=HTML&aged=0&language=en&guilanguage=en>

with lower VAT rates. As a result, Member States have seen their revenues eroded. I am particularly proud of the new procedure to allow businesses to electronically claim VAT refunds from other Member States in which they are not registered but have paid VAT. This change from a paper-based to an electronic system means that refunds for businesses will be faster and easier.”⁵⁴⁷ This statement illustrates the perspective that with these regulations in place, electronic commerce will be further enabled. However, it still requires a burdensome and potentially expensive effort, and implementation of infrastructure by the Member States to comply with the requirements of the electronic system.

3. Is EU being efficient?

Many of these developments introduced by EU have been under a lot of criticism from academics and businesses, especially from the United States, regarding them as not fair⁵⁴⁸. EU has taken the most sensible approach at this time to prefer that VAT to be charged where the item/service is consumed rather than where its supplier may be located. There is no discriminatory treatment towards non-EU traders, and the Directive

⁵⁴⁷ *ibid*

⁵⁴⁸ The 2003 Regulations have been attacked by people claiming that they will produce unfair results between EU and non-EU traders. See Ivinson J, 2004 “Overstepping the Boundary – How the EU got it wrong on Electronic commerce”, *Computer and Telecommunications Law Review*, 10(1),(1-4)

has been approved by WTO⁵⁴⁹, an indication that commercially it makes sense as well as it does not create antagonistic competition between the different jurisdictions. Ideally the best approach to be taken for the problem of taxation in the stage of electronic commerce to seize, is for VAT systems to be modernised and simplified with careful consideration on the OECD guidelines as factors which should increase efficiency. That could be achieved by devising a formula of a universal globalised tax system, which will follow the principles of OECD. By following these 5 rules and by all the different jurisdictions agreeing to a common solution it could be possible to talk about an internationally-agreeable tax system applicable to electronic commerce. In the EU for instance the way VAT is treated in relation to electronic commerce transactions still is characterised by differentiations, which indicate the different Member States' socio-economical perspectives as well as the different significance laid upon it by them⁵⁵⁰. This is both beneficial, allowing the different Member States certain degree of independence but can also create a distortion of competition between them and allow advantages on the playing field for some over the others. And because of the nature of electronic commerce, its taxing has to be an agreed plan not from a single jurisdiction but a group of them; it doesn't have any boundaries, so why should its regulation only be made taking state's borders into account?

⁵⁴⁹EUROPA (2006) "How VAT works?" – "FAQ", http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/article_1610_en.htm

⁵⁵⁰ For example, Luxembourg capitalises more efficiently by having a lower VAT rate compared to most other Member States

3.1 EU Directive: a good thing?

It is evident that the EU is trying to tackle any issues that can potentially appear, and at the same time tries to do that without halting development of the Market forces and more specifically electronic commerce. There has been considerable amount of criticism because of some of the more recent legislative attempts (the EU VAT and Electronic commerce Directive). Academics and experts from business sector regard them as unfair or inapplicable on the electronic commerce stage specifically. Most of criticism is originating from the United States, where they are not regarded as “being fair”⁵⁵¹. The decision of EU to change the tax system so that VAT is to be charged where the service/good is consumed, rather than the supplier’s location, seems to be sensible and more viable as an option. A lot of arguments have been based on the “discriminatory treatment towards non-EU sellers”. However, that does not seem to be the case⁵⁵² because EU is working towards providing more options to simplify the compliance requirements for sellers⁵⁵³. EU is not simply producing one or two Directives a year but a significant number of publications in regard to all types of taxation, from income taxation to custom duties and tax administration procedures, as well as significant

⁵⁵¹ The 2003 Regulations have been attacked by people claiming that they will produce unfair results between EU and non-EU traders. See Ivinson J, (2004) “Overstepping the Boundary – How the EU got it wrong on Electronic commerce”, Computer and Telecommunications Law Review, 2004, 10(1),(1-4)

⁵⁵²EUROPA (2006) “How VAT works?” – “FAQ”, http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/article_1610_en.htm

⁵⁵³ For instance the “one-stop shop”

amount of publications in the form of reports and consultations, for instance yearly reports on tax activities, concerns and developments produced by the European Commission.⁵⁵⁴

As mentioned before the most criticism for EU's regulatory attempts on taxation and electronic commerce comes from the US, which is not surprising considering the difference in tax systems and administration as well as the profitable commercial ties between the two jurisdictions. Even a glimpse at these two major economic players' taxation approaches, is enough to identify significant differences; one example is the VAT and Sales Tax distinction. But not all the criticism is totally unjustified. EU taxation of digital transactions raises several policy questions for the United States. These include the method of taxation of digital commerce, unequal taxation grounds of EU versus non-EU firms, higher tax compliance costs for non-EU vendors and the possibility of a complaint to the World Trade Organization (WTO). Another relevant consideration is the Commerce Clause as found in the US Constitution⁵⁵⁵. As mentioned previously the Commerce Clause allows or rather ensures the oversight by the Congress, if not a more intervening role, over commercial transaction between the US States as well as commerce between them and out of US jurisdictions. Commerce Clause does not allow

⁵⁵⁴ Activity reports in the tax field
http://ec.europa.eu/taxation_customs/taxation/gen_info/info_docs/tax_reports/index_en.htm

⁵⁵⁵ United States Constitution, Article I, Section 8, Clause 3, <https://www.law.cornell.edu/constitution/articlei>

a State to impose taxation to anyone without substantial establishment, or “nexus” as actual physical presence in a jurisdiction was described in the Quill case, within the specific jurisdiction. This in itself can pose a significant potential problem as the attempts by EU can be conceived as trying to step over the commerce clause and create a significant advantage for EU vendors as well as disadvantage US sellers. The issue of requiring a foreign firm to collect tax on sales at multiple rates depending on the customer’s country of residence is one that US vendors do not find a preferable solution.⁵⁵⁶

First, sellers from outside EU, US and non-EU e-sellers could face administrative burdens, which may result in significant financial cost. The non-EU sellers will have to register with a jurisdiction of one of the Member States, which could end up rather expensive initially, as well as harmful to their business if they choose a jurisdiction with higher tax rates. The issue of different VAT rates with every country having a different rate, is making it harder for accounting for a non-EU seller; and it also creates the matter of rate discrimination and the so called “tax havens”, for instance Luxembourg. Each vendor from outside the EU will have to ensure he is aware and has accounting systems in place to tackle the different rates from all the potential EU consumers from different countries. There is also the potential of International Trade conflicts, as

⁵⁵⁶ EU Tax on Digitally Delivered Electronic commerce, 2005, Congressional Research Service Report for Congress http://ipmall.info/hosted_resources/crs/RS21596_050407.pdf (September 2010)

Gartner analyst French Caldwell told the Electronic commerce Times⁵⁵⁷. It could potentially damage commercial relations between long standing partners in a specific area of commerce. Another issue is the non-attendance to the “neutrality” principle; services are standard-rated, while the equivalent goods can enjoy reduction of the applicable rate. Finally, there is a prerequisite for the EU to be able to enforce efficiently the new VAT rules; that is online identification of customers, and because currently it is difficult, that can incur further costs for sellers.

The first issue is that of administrative burden on non-EU sellers imposed by the Directive. There is a concern that the accounting requirement will be difficult to handle, especially for the small-sized businesses. One reason is the disparity between the VAT rates amongst the EU MS; it ranges from 15% in Luxembourg to 25% in Denmark and the same in Sweden. In order to avoid distortion of competition and the development of the Internal Market, from the beginning the EC proposed that all Member states have only two rates of VAT⁵⁵⁸; that was also a means for making the initial steps for harmonization of VAT rates. From the beginning of 1993 all Member States should apply a VAT rate not less than 15%⁵⁵⁹, and also they may apply a reduced rate, not less than 5% though, to specified categories of services and goods. It is evident that EU has not

⁵⁵⁷ <http://www.ecommercetimes.com/story/16370.html?welcome=1212922812>

⁵⁵⁸ Whitehouse, C, Revenue law : principles and practice, Butterworths, 1983

⁵⁵⁹ http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/index_en.htm,

been dictating exact rates to its Member States, but only produced guidelines, which may endanger commerce, i.e. by having different Member States applying distinctly different VAT rates. The non-EU seller has to be aware of the location of the consumer so as to assign taxes at the proper rates. If a non-EU vendor wants to register in Greece, and has customers in Great Britain, Germany and Sweden, then he must know that the respective tax rates are 17.5, 16 and 25 per cent. Also, it means the seller will be able to successfully locate the buyer's location and that would probably mean administrative workload and technological burden and cost on the sellers. The issue can be more problematic since EU sellers can charge a flat tax rate for all purchases made by private consumers within EU, while non-EU sellers will have to locate their buyers, and charge tax at the appropriate geographically rate. In case the non-E.U. seller registers in a Member State which has a rather high VAT rate, this non-E.U. seller might be discriminated compared to his European competitor who is registered in a low VAT rate country, such as Luxembourg. The real situation is not as such. Actually the rate disparity amongst the EU MS, can prove beneficial to the non-EU vendors, because they can choose where to register (for the purposes of the Directive), thus having the option to choose the lowest rate country, Luxembourg. Most of EU sellers will not have that opportunity; it would be very difficult to re-locate and move everything to a lower-tax rate jurisdiction, since their country of establishment is determined by their presence there (offices, employees, etc.). Hence the non-EU sellers have no requirement for a

physical presence, where they register for VAT purposes. Different VAT rates are creating competition between MS; an example is the fact that AOL and Amazon.com moved their European headquarters to Luxembourg. This competition within the European Union does provide healthy competition amongst the Member States; also, the VAT rates applicable can be altered so it does not create a rigid obstacle, but rather ensures certainty without removing flexibility.

Considering a global perspective on these initiatives, EU's attempt could be seen as a reason to initiate friction between US and EU. The differences presented by both sides and the bold regulatory approach by EU can be an indication of potential problems. "It also could cause international conflict". Gartner⁵⁶⁰, a leading IT research group previously predicted, unsuccessfully, that differences between EU and U.S. tax laws will become a major source of friction in international trade by 2003. The research firm said, "The EU's decision to move forward with its proposals raises the probability."⁵⁶¹ It is preferably if there was more "common ground" between US and UK, taking both sides into consideration and reach the better solution for both. But as mentioned above, the EU approach is following the OECD principles⁵⁶² and also WTO approved the Directive. That leads to the argument that EU regulatory attempts seem to be the better way

⁵⁶⁰ <http://www.gartner.com/technology/about.jsp>

⁵⁶¹ <http://www.ecommercetimes.com/story/16370.html?welcome=1212922812>

⁵⁶² Ottawa Conference Taxation Framework looked into in the previous chapter

forward, and currently (as will be discussed in the following chapter) the US is not being proactive in the taxation of electronic commerce. Another issue that can be raised is the requirement set by the Directive on the non-EU sellers to maintain a clear record of their transactions. The transaction record is for the tax authority of the MS of consumption to be able to identify the correctness and validity of the VAT returns, basically check whether the vendor is complying with the VAT rules; this is an activity that can prove to be time and money consuming.⁵⁶³ A future thought for the Commission, which again shows the willingness and forward thinking in respect of tax regulation, is the scenario of having the same VAT rate in all MS⁵⁶⁴.

Another issue that can be raised is the potential failure to adhere to the principle of “neutrality”. It is not because of the Directive’s provisions that this problem is created; but the Directive does not provide for its solution. All MS have certain goods charged at the rate of 0% or a reduced VAT rate⁵⁶⁵. One example of that is a book; the price of a printed copy of a book would have a reduced VAT rate applied to it. However, a book in its digital form, an e-book, if downloaded from the server of the publishing company or an electronic bookshop, then the normal VAT rate would apply. Newspapers and work

⁵⁶³ Hardesty, (2000c) 'EU Continues Efforts to Tax Digital Products', E- Commerce Tax News, 22 October 2000, <http://www.ecommercetax.com>

⁵⁶⁴ Sijbren Cnossen, How Much Tax Coordination in the European Union? International Tax and Public Finance, Volume 10, Number 6, 625-649

⁵⁶⁵ Re the UK <http://www.hmrc.gov.uk/vat/forms-rates/rates/goods-services.htm>

of musicians are under the same regime. This “special treatment”, the reduced or 0% rate, is applied to the tangible form of goods, but not to the digitized ones. That infringes the principle of neutrality irrespective of the medium as described by OECD, which basically means that a book, no matter the form, no matter if it’s purchased online or in a bookshop, should have similar treatment by tax authorities. Because the fact that the different forms of a book get different treatment from tax authorities, may hinder the development of different types of markets, a traditional bookshop may be able to get better prices than an online e-book bookshop, meaning the customers will prefer the traditional bookshop if they are looking for the less expensive version of the item they are interested in. Also, it does impose another obligation on sellers; they need to know, other than the normal rates of goods and services in a specific jurisdiction, the reduced rates and which goods are at 0% VAT rate in each of the Member States.

A vital component for the EU is to ensure the enforcement of the new rules is to successfully identify the consumers. Online identification of consumers is the key to the enforcement of the current legislation, but even with the use of technology a seller may not be able to accurately locate the consumer and verify their VAT status (if they are registered). If the tax authorities manage to acquire the technology necessary for online identification of consumers, then the enforceability of the Directive can be more efficient and the compliance rate higher. But if the situation is at the opposite end, then

it is difficult for the authorities to monitor the adherence to the rules. The Directive does not provide any guidelines or indication on the monitoring and enforcement of its provisions on EU and non-EU sellers, which, in correlation with the nature of online environment, is problematic. Solutions that may prove functional can be the seller to ask the buyer to fill in basic details about him, including, if not an address, country of residence and maybe email, which sometimes can be indication but not always. The Directive is also been noted to be a pioneering one, in terms of economic and taxation policy making. EU by this Directive managed to enforce regulations not only within its jurisdictional and geographical boundaries, but also established a system of VAT rules outside Europe⁵⁶⁶.

The main reason for the new taxation rules to be proposed and implemented was the elimination of the clear advantage the non-EU vendors had prior to the Council Directive 2002/38/EC. Under the new rules, EU suppliers are no longer obliged to levy VAT when selling on markets outside the EU. Previously under tax rules, EU suppliers had to charge VAT when supplying digital products even in countries outside the EU. As was illustrated above, from the initial attempts of EC to regulate tax, to the current Directive related to tax and electronic commerce, there is a clear indication of EU's considerate and revolutionary, at times, law-making process. Developments to date have shown that the

⁵⁶⁶ One jurisdiction affected was the US, as the other major actor in the electronic commerce area.

new VAT strategy has introduced a “fresh” debate in discussions on VAT harmonisation between the Member States. This consultation process should give rise to much needed improvements in Community legislation, even if harmonisation does not materialise, so that the oldest VAT system in the world can meet the demands of the 21st century.⁵⁶⁷

3.2 What next? Opportunities or retaliation? The Regulation (EU) No 1042/2013

The legislation so far, with the amendments and the regulations and proposals, all point towards a right direction in attempting to consider all the interested parties, through series of consultations and communications about any proposed change, or legislative effort. However there are flaws that need to be considered and the appropriate bodies to ensure the flaws are eliminated. A couple flaws need careful consideration in regard the Directive on VAT and electronic commerce; namely the burden of compliance for non-EU sellers and the technological support to efficiently identify online consumers. Another issue is the need for a distinction between small businesses and large ones; a small business will need a lot more professional advice and will have a higher cost for complying with the EU rules on electronic commerce taxation. Therefore this may be a hindering factor for smaller businesses to consider EU as a market for their services.

⁵⁶⁷ “Future changes to the 6th VAT Directive” by Mr Stephen Bill, Head of the VAT and other turnover taxes unit, 1/06/2004, http://ec.europa.eu/taxation_customs/resources/documents/article_on_future_changes_of_sixth_vat_directive-en.pdf

The criticism from US mainly indicates that the EU Directive 38/2002, despite the obvious support from within EU, is not equally appreciated outside this jurisdiction. While EU has a large number of internet users⁵⁶⁸ it could find itself faced with hostility from other big jurisdictions, mainly the US, where the enactment of the EU Directive 38/2002 has been seen as an opportunistic action to materialise on the sheer number of users, while being discriminatory to non-EU companies.⁵⁶⁹ The potential outcome of the allegedly discriminatory provisions of the Directive⁵⁷⁰ could be retaliation from EU's competition on the electronic commerce field, facing the likelihood of other jurisdictions enforcing similar laws creating a disadvantage on sellers operating out of EU.⁵⁷¹

From 1 January 2015, EU has put in play a new regulation for supplies of telecommunications, broadcasting and electronically supplied services made by EU suppliers to private consumers and non-business customers in order for the transactions to be taxable in the Member State of the customer, where consumption does take place, thus updating Council Directive 2008/8/EC.

The updated Article 58 reads *"The place of supply of electronically supplied services, in particular those referred to in Annex II, when supplied to non-taxable persons who are*

⁵⁶⁸ Tedeschi (2003) reports survey results and other data from eMarketer (2003) that show that, at the time the EU directive was enacted, the number of Internet users in the EU exceeded that of the United States for the first time (221 million vs. 196 million).

⁵⁶⁹ Schneider, 2005,

⁵⁷⁰ Many academics such as Ivinson (2007) and Milhecia (2007) argue that they are discriminatory against non-EU companies operating within the European Market.

⁵⁷¹ Alimo N. And Scheider G. 2011, Proceedings of the Academy of Legal, Ethical and Regulatory Issues, Volume 15, Number 1

established in a Member State, or who have their permanent address or usually reside in a Member State, by a taxable person who has established his business outside the Community or has a fixed establishment there from which the service is supplied, or who, in the absence of such a place of business or fixed establishment, has his permanent address or usually resides outside the Community, shall be the place where the non-taxable person is established, or where he has his permanent address or usually resides”⁵⁷²

The EU Implementing Regulation (Council IR 1042/2013)⁵⁷³ was implemented by the EU as the next logical step considering electronic commerce taxation and specifically telecommunications and electronically supplied services. The situation prior to this change was that EU-based vendors who were involved in B2C supplies of electronic services to customers in the EU were to account VAT on all B2C sales in their jurisdiction regardless of which EU Member State the customer is resident or established in. Vendors located outside of the EU the supply of electronic services to consumers and non-taxable will operate under the principle of electronic services and goods purchased

⁵⁷² COUNCIL DIRECTIVE 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32008L0008&qid=1400743829986&from=EN>

⁵⁷³ Council Implementing Regulation (EU) No 1042/2013 of 7 October 2013 amending Implementing Regulation (EU) No 282/2011 as regards the place of supply of services , <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R1042>

are consumed within the EU therefore VAT of the Member State of the consumer will be applied.

Another important aspect relating to new Implementing Regulation is in relation to the One-Stop Shop scheme, also known as the VAT on e-services (VoES) scheme, which is to assist the suppliers with a framework or mechanism to account for any VAT due across any of the Member States. Council Implementing Regulation (EU) No 967/2012 – obligations under the one-time registration scheme⁵⁷⁴. The One Stop Shop scheme was already present and the vendor had to be established in one of the Member States in order for VAT to be applied at the rate of that specific jurisdiction. Under the new regulations the vendor needs to be certain of the changes and applicable principles, something which has been assisted heavily by the EU setting up preparatory workshops and providing plethora of relevant information to ensure a problem free transition⁵⁷⁵. The vendor can register in each of the Member State where they have customer basis and use a web portal in the Member State of identification to account for VAT on each of the supply of electronic services to a consumer in another Member State. The vendor has to get accustomed to the specific tax rates; a rather complicated prospect considering that each Member State would have at least a standard and reduced rate of tax as well as considering the expanding EU membership. By registering under the

⁵⁷⁴ Council Implementing Regulation (EU) No 967/2012 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:290:0001:0007:EN:PDF>

⁵⁷⁵ Implementing Regulations: - Council Regulation (EU) No 967/2012: obligations of businesses, - Commission Implementing Regulation (EU) No 815/2012: single multi-country declaration, exchange of information, IT specifications and webportal functionalities...

scheme known as Mini One Stop Shop (MOSS) it will allow the provision, as with the previously existing scheme (VoeS), that by registering in one Member State of identification, that country collects and distributes VAT for all other countries where consumers may reside and the value of all B2C supplies made in all EU Member States can be reported as a single electronic return⁵⁷⁶.

4. Conclusion

The VAT and Electronic commerce Directive has been criticised heavily. But it proves successful and efficient towards what it was put in place for; balance the market power of EU and non-EU sellers. Enforcement will be difficult, even though more solutions are appearing; a new one could be the use of geo-location software. Online retail sales in Europe were set to jump 20% during 2010 and be worth €172bn (\$241bn). Electronic commerce will account for 5.5% of all retail sales within Europe.⁵⁷⁷ One more concern is that all this law-making is directed towards a very small percentage of the market. B2C market was rather small, 90% of online sales are B2B sales⁵⁷⁸, in 2002 when the Directive was initially brought in place, and still is only a very small percentage of online

⁵⁷⁶ Implementing Regulation (EU) No 282/2011, Art 9a

⁵⁷⁷ <http://econsultancy.com/uk/blog/6426-electronic-commerce-stats-round-up-2> (August 2010)

⁵⁷⁸ European Union, Press Release No. 5/02, 13th February 2002, www.eurunion.org/news/press/2002.htm

commerce.⁵⁷⁹ Between 2004 and 2008, the percentage of individuals who had ordered goods or services over the internet for private use in the past year in the EU25 rose significantly, from 22% to 34%. In 2008, 32% of individuals in the EU27 had ordered online⁵⁸⁰. The European online revenue of B2C goods and services grew by 16.3% meaning that within this, the EU28 achieved a B2C e-commerce turnover of € 363.1 billion and the following year that rose to € 424 billion⁵⁸¹. In 2014 a very noteworthy 15% of all European Citizens (within Members States of EU28) bought either a tangible good or a service from a vendor located within one of EU28 Member States, an increase of 25% compared to the previous year⁵⁸². There were certain concerns that different tax rates in EU Member States, administrative costs and the perhaps “cavalier” and daring approach of the EU in legislating the 2002/38/EC Directive, may have adverse effects for EU and EU based customers⁵⁸³, by a potential prohibition of EU customers to purchase from US sellers. However, the statistics available do not indicate such adverse consequence, even considering the ongoing financial crisis; on the contrary the evidence shows the continuous growth of ecommerce as a manner to purchase goods and

⁵⁷⁹ Information and Communication Technologies, 19 January 2010, http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/4-19012010-BP/EN/4-19012010-BP-EN.PDF

⁵⁸⁰ COMMISSION STAFF WORKING DOCUMENT: Report on cross-border electronic commerce in the EU February 2009, http://ec.europa.eu/consumers/strategy/docs/com_staff_wp2009_en.pdf

⁵⁸¹ Ecommerce Europe, 2015, European B2C e-commerce report 2015, <https://www.ecommerce-europe.eu/facts-figures/free-downloads> (May 2015)

⁵⁸² *ibid*

⁵⁸³ Ivinson, 2003 Why the EU VAT and Electronic commerce Directive Does not work, International Tax Review

services and the projection for B2C e-commerce turnover is to keep rising to €477 billion by the end of 2015 and €540 billion by the end of 2016⁵⁸⁴

The more recent changes introduced by EU indicate an active attempt into regulating this area. It could be argued that it appears somewhat that EU is administering some aggressive regulatory formula in an area where there is a lot more than a single jurisdiction to consider; the Member States within EU do share similarities in their relevant frameworks but this is something implicating sellers not just from within the EU28 but also from overseas, mainly the US. The new Regulations create a better defined tax system especially for services supplied electronically and the officials are of the opinion it is for a more efficient and easy system⁵⁸⁵ and there was significant effort to prepare and inform relevant vendors and consumers⁵⁸⁶. EU's updated regulation puts Europe ahead of other actors in the area because on the one hand it is meant to make things simpler for the involved parties, something not common for taxation, and on the other hand it is a framework which will impact on the supply of electronic services to other jurisdictions too.

⁵⁸⁴ Ecommerce Foundation, 2015, European B2C Ecommerce Report 2015 Light version,
<https://www.ecommercefoundation.org/report-info/40/European-B2C-Ecommerce-Report-2015>
⁵⁸⁵

Telecommunications, broadcasting & electronic services – Rules applicable as from 2015,
http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm#qanda
⁵⁸⁶

Due to its growth and projection of further development the European market is too important to be left alone by the US, or generally non-EU based sellers and companies, who would not exclude European customers as that would be a move making no commercial sense. EU has taken some steps which seem rather promising, but it will require consensus from a lot of important actors in this area for such a significant challenge to be met and resolved efficiently and in a way that makes financial sense for all involved. That is why the next chapter will look into the different approaches applied, continuing from where this chapter left, and mainly focus on the main “opponent” of the European Union being the approach taken by the US.

6. Discussions on Efficiency, Vat & Sales Tax

Contents

6. Discussions on Efficiency, Vat & Sales Tax	255
1. Introduction	259
2. Are the current initiatives going to the same direction?	260
2.1 VAT and Retail Sales Tax; or VAT vs. Retail Sales TAX?	262
2.2 Theoretical Responses	263
2.3 Regulatory Responses	267
2.4 Does VAT mean better cooperation and efficiency?	268
2.4 Is VAT the better option?	269
3. Conclusion	273

As discussed in the earlier chapters the close economic integration within the European Member States should provide a certain degree of preparation to consider and confront numerous problems and challenges relating to taxation from a unified perspective. The Single Market being a major element of the European Union's operation aspires to creating and promoting growth, productivity and employment across the Member States. In the process of creating this economic and social union, characteristics identified before with the distinction of jurisdictions have been progressively removed. One of these defining characteristics identified with borders and distinction of jurisdictional framework is taxation.

The character of taxation and a tax regime, as mentioned previously and as discussed initially by Adam Smith and subsequently by other tax theorists, is associated with its application within a specific jurisdiction with well-defined geographical borders. This makes it challenging from the very beginning not only when the discussion is relating merely to online commercial transactions and the relevant tax implications, but also when the debate is on harmonisation of tax regimes. Within the European Union it has been possible to achieve a significant degree of coordination however complete harmonisation seems to be a difficult task. Tax policy is still created and applied depending on the locality and the attributes of the jurisdiction and its people; for the different jurisdictions to achieve better results there would need to be cooperation and

some compromise on policy matters in order to move towards a unified homogenous system of consumption taxation. Factors such as the locality and cultural background cannot be overlooked by Governments and Tax Authorities. Not establishing an accurate framework can cause imbalances between the participating States, resulting to tax competition and inability to efficiently integrate the tax policies into the local tax regimes, thus being moved further from harmonisation or even unification.

Existence of separate and significantly different tax regimes between the Member States becomes more problematic within the European Monetary Union. Electronic commerce has created the challenge and the opportunity for tax authorities to be prepared to confront numerous problems relating to tax policy and implementation, especially when the implications are directed towards more than one jurisdiction. With the advent of the internet and its use for commercial purposes, there is the need for a common outlook towards an accurate approach for the potential that is presented within the efficient operation of electronic commerce.

1. Introduction

Previously, there was discussion on issues tax administrators have faced and may face currently due to growth of Internet and electronic commerce, as well as the background issues and what have been the regulatory attempts to control and improve on the consumption tax implementation for the online commercial arena. Considering all the aforementioned elements illustrates how the situation has been and currently is, but the analysis need to consider what will, or what can, happen in the future as far as online taxation is concerned. This chapter will focus on the discussion of prospective suggested solutions and ideas put in place by the major actors in the area of electronic commerce as well as theoretical suggestions. There will be an analytical approach to these opinions in order to assess the merits of each one. As a starting point, VAT and its

nature should be considered in a wider context, but not without bringing in and comparing Sales Tax to it. In addition, international cooperation in taxation is happening but how likely is it to adapt and adjust as a consumption tax on e-commerce transactions. There will be some discussion into the international approaches and their merits as identified previously in the thesis, in order to set the scene for the following chapter.

2. Are the current initiatives going to the same direction?

The EU and the US followed, to an extent, the OECD's suggestion on governance of electronic commerce taxation, especially relating to consumption taxation on online commercial transactions.⁵⁸⁷ Their policy direction though has not been the same, as they assumed different perspectives on the aspect of electronic commerce taxation. The US took a "wait & see" approach, especially as the Federal Governing body seemed reluctant to regulate the tax specifics of online commercial transactions.⁵⁸⁸ In contrast, the EU took a more practical view on the matter⁵⁸⁹ and imposed regulation to try and tackle issues arising due to technological developments and the growth of electronic commerce. In the US the lack of regulation from the Federal Government resulted in a

⁵⁸⁷ Consumption Tax Aspects Of Electronic Commerce: A Report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, OECD 2001 (available at <http://www.oecd.org/ctp/consumption/2673667.pdf>)

⁵⁸⁸ House of Representatives (1997) Discussion on the implementation of the Internet Tax Freedom Act, on July 17th 1997 (Available at http://commdocs.house.gov/committees/judiciary/hju43665.000/hju43665_0.HTM#0)

⁵⁸⁹ DIRECTORATE GENERAL FOR INTERNAL POLICIES POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY (2012) Simplifying and Modernising VAT in the Digital Single Market for e-Commerce, [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2012/492432/IPOL-IMCO_ET\(2012\)492432_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2012/492432/IPOL-IMCO_ET(2012)492432_EN.pdf)

divergence of opinions; some States adopted the view of imposing taxation on online commercial transactions, where others adopted a more hesitant approach on imposing consumption taxation on electronic commerce.⁵⁹⁰ The Member States of EU shared a common view that online commercial transactions should be taxed.⁵⁹¹ The different approaches taken in these two aforementioned jurisdictions perhaps indicate a different philosophy in governance and economic development, as well as political outlook. The growth and impact of electronic commerce brought forward an opportunity for such different policy and tax regimes to find common ground and work together more efficiently, ultimately producing a policy framework applicable to both and adaptable to further participating jurisdictions.

From the initial plans for VAT the scope of it was aimed at getting rid of certain frontiers between countries within the European Economic Community.⁵⁹² The problem, according to Professor Easson, was not predominantly the external frontiers, but attempting harmonisation within the common market.⁵⁹³ Within the EEC, subsequently European Union, the aim was to attempt removing the borders between Member States

⁵⁹⁰ European commission (2014) REPORT FROM THE COMMISSION TO THE COUNCIL on Article 6 of Council Directive 2008/8/EC, REPORT FROM THE COMMISSION TO THE COUNCIL on Article 6 of Council Directive 2008/8/EC

⁵⁹¹ European commission (2010) Communication from the Commission to the European Parliament and the Council on removing cross-border tax obstacles facing EU citizens, [http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/tax_policy/com\(2010\)769_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/tax_policy/com(2010)769_en.pdf)

⁵⁹² International Bureau of Fiscal Documentation (1963) "The EEC Reports on Tax Harmonisation, Amsterdam

⁵⁹³ Easson, AJ (1980) "Tax Law and Policy in the EEC" Sweet & Maxwell, Chapter 2

for tax and commercial purposes⁵⁹⁴, however significant these borders were at the time for purposes of identifying imports at the point of entrance in the destination country. Harmonisation within the EEC and later on within the EU was not a simplistic procedure and difficulties were recognised in achieving that goal successfully and producing a positive framework for all Members States involved in the process.⁵⁹⁵

2.1 VAT and Retail Sales Tax; or VAT vs. Retail Sales TAX?

VAT and Sales Tax have already been introduced and their characteristics have been examined, especially for their relation to electronic commerce. Is there such a gap separating the two different schemes of consumption taxes? Both have been adopted by different jurisdictions but VAT is increasingly the prevalent type of consumption tax, representing a major source of revenue for governments around the world. The contribution of VAT to overall government revenue is increasing rapidly, especially considering the current financial crisis and the pressure on Governments' to increase revenue, which in most jurisdictions does take place by raising taxes⁵⁹⁶. This has not been only done for the two big actors in the area, the EU and the US, but also for other

⁵⁹⁴ Dir. 67/227, Art 4; Dir. 67/228, Art 19; Dir. 77/388, Art 35

⁵⁹⁵ Report of the ESC Section of Economic and Financial Questions, Doc CES846/78, point 4.2.2.3 (The Fredersdorf Report)

⁵⁹⁶ Taxation trends in the European Union (2012)

http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2012/booklet.pdf

jurisdictions with Japan being one for which IMF suggested the increase of VAT rates⁵⁹⁷ and the suggestion being that increased taxation will help reduce national budget deficits.⁵⁹⁸ VAT is the type of consumption tax predominantly used in many jurisdictions around the world, so it allows for the potential to attempt a cooperation of these systems. Even new jurisdictions are considering and making the necessary adjustments to their systems to introduce consumption taxation as a more efficient method of collecting revenue, an indication of its characteristic of efficiency and reward it presents to the State⁵⁹⁹.

2.2 Theoretical Responses

As discussed earlier, the US the tax system does not impose consumption taxes on a federal level so that they would be applicable to all the States; instead sales taxes are established and administered by each State or specific locality. The implication of such a regime, with 5 States not imposing Sales tax and the other 45 imposing a variety of taxes, is that it significantly increases the complexity of administration and can affect

⁵⁹⁷ Michael Keen, Mahmood Pradhan, Kenneth Kang, and Ruud de Mooij (2011) Raising the Consumption Tax in Japan: Why, When, How?, IMF Staff Discussion Note, (available at <http://www.imf.org/external/pubs/ft/sdn/2011/sdn1113.pdf>)

⁵⁹⁸ OECD, Tax Notes International, Sept. 20, 2010, "An International Perspective on VAT," by Alain Charlet and Jeffrey Owens, www.oecd.org/dataoecd/47/45/46073502.pdf.

⁵⁹⁹ Meredith McBride (2015) Shifting the balance: Asia's move to indirect tax, International Tax Review, <http://www.internationaltaxreview.com/Article/3457042/Shifting-the-balance-Asias-move-to-indirect-tax.html?ArticleId=3457042>

the effectiveness and revenue collection by the State⁶⁰⁰. Even though within the EU there are differences to the tax rates and the Member States' effectiveness in administration of tax regulations, in the US sales and use taxes suffer from distinct lack of uniformity in respect to matters of what should be taxed, tax rates and calculating the tax bases⁶⁰¹. Trying to evaluate the challenging are of e-commerce consumption taxation becomes more complicated when considering the US tax regime and its characteristics; the complexity of the system and the importance of consumption taxation means that this debate is not a new one or a concluded one.⁶⁰²

Examining the discussion from a more theoretical perspective there have been some different proposals in the tax literature to cope with these challenges. One example is Professor Reuven Avi-Yonah's proposal to impose a withholding tax on transactions taking place online. The proposal indicates that any income coming from an e-commerce transaction should have tax levied where the consumers of e-commerce reside⁶⁰³. This proposal does not derive significantly from the current EU position, but it is seen as an important one considering that it was put forward in 1997 making that more than a decade before the EU regulation moved to the same direction. Another

⁶⁰⁰ Ernst & Young (2012) *Worldwide VAT, GST and Sales Tax Guide* (available at [http://www.ey.com/Publication/vwLUAssets/2013-worldwide-VAT-GST-and-sales-tax-guide/\\$File/2013-worldwide-VAT-GST-and-sales-tax-guide.pdf](http://www.ey.com/Publication/vwLUAssets/2013-worldwide-VAT-GST-and-sales-tax-guide/$File/2013-worldwide-VAT-GST-and-sales-tax-guide.pdf))

⁶⁰¹ An example of the differences in tax rates can be found at <http://www.taxadmin.org/FTA/rate/sales.pdf> as well as the online searchable database by the Federation of Tax Administrators at http://www.taxadmin.org/fta/pub/services/online/default_07.html

⁶⁰² Tax Analysts (2011) *The VAT Reader: What a Federal Consumption Tax Would Mean for America*, [http://www.taxanalysts.com/www/freefiles.nsf/Files/VATReader.pdf/\\$file/VATReader.pdf](http://www.taxanalysts.com/www/freefiles.nsf/Files/VATReader.pdf/$file/VATReader.pdf)

⁶⁰³ Reuven S. Avi-Yonah (1997) *International Taxation of Electronic Commerce*. Tex. L. Rev. 52, no. 3, 507-55

suggestion was made by Professor Doerenberg whose main focus was on the tax base. According to the Professor Richard Doerenberg idea the way to efficiently regulate consumption taxation on e-commerce transactions is to identify and efficiently control tax base⁶⁰⁴; erosion of the tax base is seen as the main problem for loss of revenue and lack of identification of the causes of such erosion leads to ineffective regulation of the area.

To approach the challenges of e-commerce taxation Professor Jinyan Li's suggests something significantly different by putting forward the idea that there is need for creating a formula⁶⁰⁵ specific for taxation on e-commerce taking into consideration the specific and diverse characteristics of the internet to fix the problem of tax base erosion. The overreaching theme of the above suggestions seem to place the focus on the idea that e-commerce is on a new platform, the internet, and that has to be accounted for when trying to assess current taxation systems. Adapting the existing rules should be seen as one of the ways to tackle the challenge.

It has been discussed earlier about the differences and challenges the Internet has brought on to theorists and those responsible for setting the policy and regulation. That

⁶⁰⁴ Richard L. Doernberg & Walter Hellerstein (2001) *Electronic Commerce and Multijurisdictional Taxation*, Kluwer Law International

⁶⁰⁵ Jinyan Li (2003) *International Taxation in the Age of Electronic Commerce: A Comparative Study*, Canadian Tax Foundation

however is not a discussion which has been finalised; there are different variables and there is the danger that the continuous growth of the Internet may force the regulators to decide without the amount of study and consideration that should be applied on such a matter.

Another perspective that needs to be observed here is that of McLure, who in 1999 suggested that the growth of electronic commerce and its implications to taxation helped to identify and start a re-evaluation of the existing system including the complexities and the problematic fiscal relationships between States and in a Federal, Union of States' sense. The main element of McLure's idea is the positive aspect of his perspective; the Internet did not bring problematic situations and incomprehensible concepts for the current rules. On the contrary, his viewpoint is that it brought about a new opportunity to build on and reevaluate, if necessary, in order to realise something that would be more fitting and more up to date as an efficient tax system for e-commerce. McLure's enthusiasm about identifying and evaluating accordingly is refreshing, especially when a lot of the literature on tax and e-commerce was characterised by a rather pessimistic outlook concentrating on the problems rather than the opportunities it could bring.⁶⁰⁶

⁶⁰⁶ The literature relevant to this discussion and the perspectives can be seen at the earlier part of the thesis.

2.3 Regulatory Responses

Cross-state e-commerce appears to challenge a state's consumption tax system as the principles pre-existing may not be applicable to the new "tax environment"⁶⁰⁷. There was reference of the approaches so far from EU and the US, as was some evidence on the growth of e-commerce transactions to indicate the significance of such regulations. In the EU for instance there has been a lot of regulation, which on one hand indicates EU's method of assessing and filtering a new set of circumstances before adjusting and reevaluating. The current status of the EU regulation on consumption taxation for e-commerce transactions indicate that experimental approach by EU; it started very differently and now with the current Regulation, as seen earlier, from the 1st January 2015 VAT is levied at the country of consumption.

On the other hand, in the US there have been steps taken to meet the challenges. An example is the enactment of Internet Tax Freedom Act, an act providing that there will be a moratorium on internet taxes and not allowing for any levy to be imposed on internet access. Another one is the Streamlined Sales and Use Tax, which is a great attempt to get together and harmonise the different States' tax principles, as well as the Marketplace Fairness Act, being the more recent attempt.

⁶⁰⁷ Morse (1997) State Taxation of Internet Commerce: Something new under the sun, 30 Creighton Law Review, 111

These regulatory methods were primarily introduced to overcome dated principles and also to create an efficient and clear of unnecessary

2.4 Does VAT mean better cooperation and efficiency?

Looking at the degree of separation of the two major jurisdictions for the purposes of electronic commerce and the development of relevant taxation policies, one can identify the main aspects of the actual tax itself; VAT in EU and Retail Sales and Use tax in the US. Between these types of consumption taxes one difference can be seen as primary; the way they are levied. VAT is levied on the consumption process, which could mean it is levied both on the producer as well as on the consumer, impacting on the price to be paid. Sales Tax, on the other hand, is levied at the very end and just once in the whole transaction; at the time the consumer purchases the product or service. Due to the fact VAT is applied at each stage of the production and sale of goods and services, it does involve a number of mechanisms. In order to avoid that multi-level connection resulting into a complicated and incomprehensible regime with lots of bureaucratic procedures, VAT regulations must have a greater degree of transparency and simplicity. The transparency comes by the VAT being present at various stages from the production to the delivery to the consumer; it provides for an opportunity to check each stage, and ensure the relevant added value has been calculated in the projected price. Overall, employing VAT for taxing e-commerce transactions should create a favourable

situation for the country collecting revenue; even though there has been criticism especially on the VAT's effectiveness in less frugal circumstances.⁶⁰⁸

2.4 Is VAT the better option?

Arguably the use of VAT can usually result in less tax evasion as well as bring further engaging of the taxpayer into compliance, since it will be clear what is levied and where, in a unified and clear system; unless of course the VAT rates are considered unreasonably high by the tax payer⁶⁰⁹. However sales tax can be more susceptible to tax evasion due to its one-stage levy. As Lisa Lim, an American tax accountant argues⁶¹⁰, VAT, in contrast to sales tax, is more efficient due to its presence at more stages from the production to the other end where the consumer receives the product or starts using the service. This can be argued but comparing the two approaches Lim's view does appear the more plausible one; VAT needs regulation in various stages of the process, while Sales Tax only once. Especially for electronic commerce this role is invaluable as the need is evident to ensure transparency and efficiency along the trail of a transaction. Consumer trust is a significant factor when considering electronic commerce; therefore VAT acting as a safeguarding mechanism throughout the process

⁶⁰⁸ Thoma Baunsgaard & Michale Keen (2005) Tax Revenue and (or?) Trade Liberalization, Working Paper WP05/112, International Monetary Fund, Washington

⁶⁰⁹ Nam, Chang Woon and Parsche, Rüdiger and Schaden, Barbara, (2001) Measurement of Value Added Tax Evasion in Selected EU Countries on the Basis of National Accounts Data, CESifo Working Paper Series No. 431. SSRN: <http://ssrn.com/abstract=267677>

⁶¹⁰ Lim, Lisa, (2011) "Applicability of VAT in the United States", The Contemporary Tax Journal. Paper 14. http://scholarworks.sjsu.edu/contemp_tax/14

surely installs further trust to the consumer. Consumer trust can be identified with Vat as consumption taxation by simply looking at it through Adam Smith's canons.

VAT is a tax that the individual consumer knows will be included in the price and therefore knows when and how it will be paid. That also means it is convenient as the way to pay the VAT on a product or a service will be rather clear. The most important aspect perhaps of the Canons to indicate why VAT enables consumer trust is the one in regard to equality. Any consumer should know that buying the same product or purchasing the same service, there will be, or there should be, an equal levy imposed, which makes the consumer more at ease and feel that they are getting the same as the person before or after them. VAT as has been discussed earlier, promotes certainty which is another element of substantial nature to electronic commerce. Tanzi and Zee⁶¹¹ discuss some of the merits of VAT over sales tax, especially in developing countries, something which could be used as an analogy to the developing nature of the electronic commerce arena. Certainty is one of the benefits VAT can establish within a jurisdictional taxation framework, because it makes it more feasible for the administration of a Federal state to have a better overview of every step from the production to the delivery to consumer.

⁶¹¹ Vito Tanzi and Howell Zee, (2001) Tax Policy for Developing Countries, International Monetary Fund, March 2001, available at <http://www.imf.org/external/pubs/ft/issues/issues27/index.htm>

For electronic commerce specifically, VAT seems to be the better option. Over the last few decades VAT has been adopted by a number of jurisdictions and currently all member countries of the Organisation for Cooperation and Development (OECD), with the exception of the US, have VAT frameworks in place⁶¹². As consumption tax VAT appears to be a better option to Sales Tax merely due to the jurisdictions it is in use; most OECD member states, but the US, use a form of VAT and that should be a testament to its advantages for collecting revenue and being well-designed.⁶¹³ One on hand, this identifies that VAT and Sales Tax jurisdictions can cooperate to a degree, either under the wide umbrella of the OECD, or through other financial, legal instruments.

There has been an attempt to identify the reasons why VAT may be a more efficient tax when it comes to consumption taxation but that is not an indication that the two different types of consumption taxes, namely VAT in the EU and Sales Tax in the US, cannot achieve successful cooperation. Another indication that the different jurisdictions can work together in a business or commercial setting is certain International Treaties; that can be seen as a common groundwork on which the taxation can be applied on a subsequent basis. A good example for that is the International

⁶¹² Jeffrey Owens, Piet Battiau, Alain Charlet, (2011) "VAT's next half century: Towards a single-rate system?" OECD Observer No 284, Q1 2011, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

⁶¹³ James, Simon (2000) "VAT/GST : The UK Experience Revisited," Revenue Law Journal: Vol. 10: Iss. 1, Article 5. Available at: <http://epublications.bond.edu.au/rlj/vol10/iss1/5>

Convention on Contracts for the International Sale of Goods (CISG), or Vienna Convention⁶¹⁴. The CISG provides an indication of cooperation on a commercial perspective between members with different economic as well as cultural and social frameworks. It is not the only relevant convention by the United Nations Commission on International Trade Law, as the 1996 UNCITRAL Model Law on Electronic Commerce⁶¹⁵ is also another attempt at soft-law regulation, and has been well received by many of the participating members. In the US there is a clear trend to avoid significant regulation on electronic commerce, one indication being the Internet Tax Freedom Act. The technological development that took place over the couple decades would have made the task of policy makers and legislators' significantly more challenging, because they would need to put forward legal frameworks and principles that could withstand changing circumstances. Especially when the proposed policies and legislation was in relation to technological circumstances there is always the danger that they can be considered dated and impractical very quickly; the CISG for instance has indicated that it has been built with flexibility in mind, avoiding compromises of its core principles when faced with the ever-changing nature of electronic commerce on a global perspective.⁶¹⁶

⁶¹⁴ United Nations Convention on Contracts for the International Sale of Goods (CISG) http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html (the text of the CISG can be found at <http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf>)

⁶¹⁵ UNCITRAL Model Law on Electronic Commerce, http://www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf

⁶¹⁶ Sieg Eiselen, (2002) Electronic commerce and the CISG: Formation, Formalities and Validity, Vindobona Journal of International Commercial Law & Arbitration 305-318.

3. Conclusion

This chapter was considering some responses to the challenging nature of Internet and trying to find a fitting type of consumption tax. There was some discussion on the merits of VAT and its efficiency; that to an extent is justified by the way VAT as a consumption tax operates by being present in more than one points throughout the process. VAT is usually compared to Sales Tax in the US as they are the two main actors in e-commerce, and there has been the ongoing debate as to why the US has not joined the rest of the OECD Member States in having VAT as a consumption tax and not Sales Tax.

That would not be a very strong argument if VAT was only in its first few years of operation. VAT has been tried and tested in many jurisdictions⁶¹⁷ and it has been a good source of revenue for the tax administrations in the jurisdictions used. From an e-commerce viewpoint, VAT is a good scheme to work as it is seen as an efficient form of taxation as well as one which can promote and develop consumer trust. Overall this chapter was used in order to set the scene for the last one; it was put first to illustrate some elements of the discussion before examining them more in depth in the following chapter.

⁶¹⁷ Richard Bird & Pierre-Pascal Gendron (2005) VAT Revisited: A New Look at value added taxation in Development and Transitional Countries, Study prepared for USAID project on Fiscal Reform in Support of Trade Liberalization, <http://www.fiscalreform.net/research/pdfs/VATR%20Final%20181005.pdf>

7. Consumption Tax principles and cooperation

Contents

7. Consumption Tax principles and cooperation.....	274
1. Introduction	276
2. Should the aim be harmonisation of the tax principles?	278
3. Harmonisation does not mean Unification.....	280
3.1 What is harmonisation?	282
3.2 Why harmonise?	285
3.3 Why not harmonise?	292
4. Maybe cooperation a better solution for the near future?	295
5. Conclusion	297

1. Introduction

The idea of cooperation amongst jurisdictions for efficient online regulation is not something new. Even though while some opinions of the experts appear divided, there are many experts, such as Genschel, who are supporting not only the significance and long existent history, but also the necessity for cooperation in this area.⁶¹⁸ Cross-border consumption taxation is a challenging area and development has been on-going, but it is an area, which should be considered alongside similar aspects of international economic development and regulation, as well as relevant technological advancements. This is likely to signify its importance for an overreaching international governance of commerce, and more specifically e-commerce, for the purpose of this thesis. Currently

⁶¹⁸Genschel, Philipp (2005) 'Globalisation and the Transformation of the Tax State' European Review, Vol, Supp.No. , 53-71

there are a large number of bilateral treaties between states globally; there are numerous double taxation treaties worldwide⁶¹⁹ attempting to bridge the gap between different jurisdictions and their different consumption tax regimes. However, bilateral treaties on their own cannot serve fully their intended purpose; they are not panacea.

John Douglas Wilson argues that inefficient taxation regimes amongst different jurisdictions can lead to excessive tax imposed.⁶²⁰ The argument he puts forward is that even bilateral treaties can distort a healthy tax competition, which should allow for a good revenue stream and a treaty with clearly defined and effective set of rules. Multilateral agreements between many states, for instance between all OECD members, could be more effective and successful.⁶²¹ That could perhaps occur due to stricter adherence to the OECD guidelines on consumption taxation; that could mean there will be a great degree of consistency on the consumption tax principles. Globalisation and the advent of Internet dictate the cooperation between more than two actors, more than two jurisdictions in such an important issue. Electronic commerce and its global increased the need for a more coordinated effort for a framework to facilitate the cooperation initially and subsequently its development further into harmonising.⁶²² This

⁶¹⁹ HM Revenue & Customs, (2012) "Double taxation agreements 2011",
<https://www.gov.uk/government/publications/double-taxation-agreements-2011>

⁶²⁰ John Douglas Wilson (1999) Theories of Tax Competition, National Tax Journal, Vol. 52, No. 2

⁶²¹ Rixen, T. and Rohlfing, I (2004) 'Bilateralism and multilateralism; institutional choice in international cooperation' American Political Science Association Meeting, Chicago, 3-7 September 2004

⁶²² Sadka, E (1999) The economics of Globalisation. Policy Perspectives from Public Economics, Cambridge University Press

chapter will examine whether it is achievable to bring together the common aspects of the different jurisdictions in regard to electronic commerce taxation, either in a harmonising aspect or merely on a solidified basis of consistent cooperation.

Previous chapters have considered the approaches by the major actors in the field, European Union and the United States, and this chapter will try to look into the different policy responses as well as identify common ground, which can help establish an international recognition of tax policies and standards.

2. Should the aim be harmonisation of the tax principles?

Different jurisdictions have always cooperated over many legal, political and commercial matters. The last few decades saw a constant furthering of internationalisation of commerce and with that cross-border connection, by means of commercial conventions and treaties as well as international tax agreements and mechanisms. This can be illustrated, for instance, by the fact VAT has been progressively adopted since 1954 by more and more jurisdictions and currently most of the OECD countries have adopted and implemented it in their tax regime.⁶²³ The aforementioned discussion has also indicated that EU and US, the two biggest players in electronic commerce, using different types of consumption taxation, VAT and RST respectively, appear to be having

⁶²³ Jeffrey Owens, Piet Battiau, Alain Charlet (2011) VAT's next half century: Towards a single-rate system?, OECD Observer No 284, Q1 2011, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

a harmonious working relationship on aspects of trade and as a result on taxation matters too. Currently a significant number of bilateral taxation treaties have been established to connect many different countries, and, as Professor Salter points out⁶²⁴ on a more specific basis, especially within EU, there has been a great effort to coordinate taxation on goods and services for all Member States collectively as well as for each individual State.⁶²⁵ There are already conventions and other collaborative agreements in place allowing for cooperation, economically and financially, or even harmonious co-existence of two taxation systems from different countries, therefore maybe it is time to consider of the next step forward being that of harmonisation.

The reason for that could be extracted from the reality of cross-border electronic commercial transactions taking place, and doing so in a progressively larger scale, which is contradictory to the traditional taxation principles of state autonomy and total state control insofar its own tax jurisdiction. Therefore the reality of wider reaching cross-border and electronic commerce create a challenging situation for the conventional tax regimes, which largely were focused within the specific limits of one jurisdiction. For these reasons, and the ones mentioned in the first chapter detailing the challenges tax authorities are facing, there may be a need to research further and examine the

⁶²⁴ Salter (2001) Electronic commerce and International Taxation, International Business Law: Electronic commerce and the impact of globalisation on the law, New England Journal of International and Comparative Law Symposium, New England School of Law, April 10th 2001

⁶²⁵ Bolkestein Frits (2001) Harmful tax competition, VAT on digital deliveries, taxation of savings, Address to European American Business Council, Washington D.C., May 9th 2001

possibility of bringing different tax systems and different jurisdictional perspectives close enough to create a homogenous and harmonised regime. So is harmonisation the key to an efficient international approach to levying consumption taxes on electronic commerce transactions? For that to be answered, harmonisation and its characteristics and merits will be discussed; but before there is the need to identify what harmonisation is not.

3. Harmonisation does not mean Unification

First of all, before discussing the necessity or not for harmonisation, it is important to make a distinction to clarify the argument. Attempting to examine the possibility and the practicality of harmonisation is not the same as examining the possibility and practicality of complete unification; one is miles apart from the other. These terms can be used in a similar fashion however there is a difference in what each term denotes. When considering from an international scope bringing two jurisdictions closer for the purposes of a bilateral treaty or a convention, then what is mainly sought to be achieved is a way to find the common elements between the two. However, one other way it can be done, as Zeller points out, when the wanted outcome is complete uniformity of laws is by transplant; an existing law from one jurisdiction is set up and implemented in the second jurisdiction; transplant of laws is meant to be a quick process to result to a

“borrowed but functional” law.⁶²⁶ Harmonisation is not the same as unification of laws; when considering harmonisation of consumption taxes relating to electronic commerce; it does not mean “*let’s make it all the same*”! Harmonisation could be considered as an initial stage, the opening step forward towards unification. For the harmonisation process to be efficient it seems that it requires in-depth study of comparative law, and as Boodman argues harmonisation is a creation of comparative law.⁶²⁷ The justification of this follows from the understanding of its nature; harmonisation is trying to study and assemble similar or common characteristics of two or more jurisdictions, in order to bring them to a common outcome. There is the opinion that unification is preferable to harmonisation, especially for international trade aspects therefore can be expanded to the fiscal element of electronic commerce taxation. The two aforementioned academics, Boodman and Zeller are both in favour of unification⁶²⁸, as they see it the better solution and the further logical development after harmonisation has been established⁶²⁹ as well as agreeing with the argument that after harmonisation is achieved what you have with one set of regulation or laws is unification.⁶³⁰ Ultimately

⁶²⁶ Zeller Bruno (2007) CISG and the unification of international trade law, Routledge Cavendish

⁶²⁷ Boodman (1991) The myth of harmonisation of Laws, 39 AJCL 699

⁶²⁸ Predominantly their arguments are aimed at international trade, but following on from previous arguments, there is a parallel drawn for the extent of which international cooperation, or mutual assistance can exist efficiently

⁶²⁹ Zeller Bruno (2007) CISG and the unification of international trade law” Routledge Cavendish

⁶³⁰ Glenn P, (1993) Harmonisation of Law, Foreign Law and Private International Law, European Review of Private International Law 1

Heidemann argues that harmonisation is a term to describe the beginning of the process of, or the starting of uniformisation.⁶³¹

3.1 What is harmonisation?

Electronic commerce has created a wider spectrum of opportunities for cross-border commerce and for further enhancing the online commercial experience. Earlier in the discussion there was mentioning of the constant development of electronic commerce, and what percentage it slowly accumulates of the total commercial activity; this is still rather small and gets even less when considering only business to consumer, or consumer to consumer online transactions. However, it still represents only about 15% of the total revenue in EU.⁶³² Another exciting prospect is that developing economies will be taking a more active role and provide a higher percentage of electronic commerce sales.⁶³³ Therefore, harmonisation for a wider audience of developed and developing countries would be beneficial and promote commercial and political links further ahead.

⁶³¹ Heidemann, (2007) Methodology of Uniform Contract Law, Springer

⁶³² Overall, electronic commerce sales present between 14-15% of the total revenue in the EU27, Turnover from electronic commerce broken down by web and EDI type sales, 2010, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Electronic_commerce_statistics

⁶³³ Fredriksson (2013) Electronic commerce and Development Key Trends and Issues, Workshop on Electronic commerce, Development and SMEs – UNCTAD, 8-9 April 2013 WTO, Geneva, Switzerland

The European Commission's policy in respect to consumption tax harmonisation, for taxes in general but also for VAT related online transactions, was the first step and formed the guideline for the European Union's policy consequently. As mentioned earlier, bringing closer the different Member States' tax regimes was an objective of the early Tax Directives but this objective was not to take priority over the European Community's other major policy initiatives. This chapter focuses on electronic commerce and the controversial and challenging aspect of managing to properly fit consumption taxation within such transactions. It is something which has global relevance, as internet does help making electronic commerce easily accessible almost anywhere, rather than say borderless. The statistics show that this marketplace is still growing, it does not yet match traditional forms of commercial activity, and however there is the potential that it could continue to increase and even by new means, such as a smartphone⁶³⁴. This growth could signify a very important development in international governance in the coming decades, the rise of the need of a global taxation regime or a globally harmonised taxation regime.

Harmonisation of consumption tax for e-commerce transactions would ultimately mean trying to find common ground and set some groundwork. The common ground should be considered in regards to tax principles within each jurisdiction, in order to find the

⁶³⁴ Sumita, Ushio, and Jun Yoshii. (2010) Enhancement of electronic commerce via mobile accesses to the Internet, Electronic commerce research and applications 9.3 217-227.

thread going through each one of the tax systems. After this step, a scheme can be put together in order to establish the need for compliance and also to specify steps for effective administration. One aspect relevant to administration would be to engage technology and some intermediaries which can be extremely useful with some elements during the process. Using technology would make it easier for information to be exchanged such as payment and services details. The main premise of the proposed harmonisation is that it is made on the basis of tax principles; the different jurisdictions should be cooperative with the other ones in order to tackle early on how the system works and any potential mishaps. The idea behind it is sharing a common understanding for tax principles would automatically make it easier to move forward on aspects such as non-compliance, fraud and others. The proposal stems from the idea of EU and its developmental approach in such matters as seen earlier in the thesis with the approach it has taken in regards to e-commerce taxation from the early stages to the current one. The tax principles adopted could be derived from the OECD 1998 Conference or even starting from further back, by considering the 4 Canons by Smith.

The reason a harmonised scheme would work is because due need to not allow electronic commerce transactions to be excluded from taxation, due to the revenue that could be not accounted for, as well as trying to efficiently operate on the realisation that taxing electronic commerce need close cooperation between jurisdictions. However

when considering harmonisation as a possible solution to a more efficient tax regime for consumption taxes on electronic commerce transactions, it does not necessitate that all jurisdictions rush in from the beginning. The two major players in this area, and two of the biggest economic strongholds, are the EU and the US, and the harmonisation process could start with them, complicated though it may be. The US has a variety and a plethora of taxes that apply, whereas the EU is a good example of uniformity to an extent, but not total harmonisation of consumption taxes.

3.2 Why harmonise?

The European Union is a good example of a multi-jurisdictional market, operating under a unified market principle. Many of the problems related to electronic commerce consumption taxation within the EU27 have been addressed, as discussed earlier, either by means of Directives (for instance Dir. 2002/38) or by consultations and guidelines for the Member States. Based on that argument surely the reasons for tax harmonisation within the EU, a unified market consisting of Member States with distinct characteristics, culture and history, would be also applicable and providing the basis for electronic commerce consumption tax harmonisation in a wider spectrum, such as extend the same principles to the US, as well as other jurisdictions, including major economies such as China, India.

Harmonisation of consumption taxes has been a concern and priority of the EE even at its earlier forms. The EEC Treaty, article 99 reads *“The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time-limit laid down in Article 7a.”*⁶³⁵ This provision was seen as compulsory; was not up to the Member States to decide if it came to fruition, but for the Commission to consider how not if such taxes can be harmonised⁶³⁶.

When considering the philosophy of the European Union, in its current and its previous forms, Mr von Groeben said that *“ Harmonisation does not mean that the tax system must be made uniform, but only that they must be mutually adapted to the extent that this is necessary to make them neutral from the point of view of competition and thus bring the tax systems into line with the competition system of the Community”*⁶³⁷ This appears to be slightly inconsistent with the very basic harmonisation approach of attempting to create a homogenous environment. To an extent what McGroeben

⁶³⁵ Maastricht Treaty, Article 99, http://www.ecb.int/ecb/legal/pdf/maastricht_en.pdf

⁶³⁶ Easson (1980) Tax Law and Policy in the EEC, Sweet & Maxwell , Ch 2 (p70)

⁶³⁷ Easson, (1980) Tax Law and Policy in the EEC, Sweet & Maxwell , p120 [Policy on competition in the EEC)EEC) Bull, 7, 8-61, p.15]

suggests a formula of harmonisation similar to the current EU one; an overreaching umbrella of regulation but some freedom within in for Member States to choose where each sets their VAT rates as well as allowing them to keep some jurisdictional authority without substantial deviation from the centralised formula for the tax system; the competition element is something that must operate within.

This indicates that initially harmonisation was seen as related to competition policy. Paris⁶³⁸ agrees with that point too and makes the argument that such cooperation is necessary to prevent sellers relocating to establish in tax havens. In the aspect of online commercial transactions it can refer to Permanent Establishment matters and whether for instance a company outside of EU, offering online purchases of physical goods or services will choose to register for VAT purposes in Luxembourg or France. A coordinated tax system stops member states competing to have lower tax rates and thus makes the operation of a fair single market easier. For electronic commerce and the wider concept of cyberspace, what is there is already an open, no borders and jurisdictions, market. Due to that characteristic of the internet, there has to be harmonisation, even if it only is to the degree Von Groeben proposed, to create a neutral element of cooperation amongst all countries involved. By taking away certain obstacles to free trade between jurisdictions, competition is not between the countries

⁶³⁸ Paris R (2003) "The globalisation of taxation? Electronic commerce and the transformation of the state", *International Studies Quarterly* (2003), 47, 153-182

anymore but the pressure is on the companies, making the cost more affordable and also ensuring the practices followed are to the benefit of the consumer.⁶³⁹

A rather realistic reason for electronic commerce tax harmonisation is of course the financial implications that are attached to it. Harmonisation is likely to bring in revenues that otherwise are getting lost because things are uncertain on who is taxing such transactions; taking into consideration as well the economic crisis and reduced ways of bringing in revenue from other resources Governments need another boost, such as a common VAT approach for instance.⁶⁴⁰ That would set the basis for not allowing further erosion of the tax base due to consumers doing their shopping online rather than through the more traditional channels. The expectation is that as long as the consumers are using the online channels for their shopping then the market should be creating revenue to return to the relevant authorities.

This element connected with the aspect mentioned in the above paragraph about the competition between the on-line retailers rather than the different States, raises the important factor of self-regulation. Tax harmonisation is likely to create and allow for

⁶³⁹ Ussher, Kitty (2000) The spectre of tax harmonisation, Centre for European Reform. Available at http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2011/p165_tax_harmonisation-1974.pdf

⁶⁴⁰ Jeffrey Owens, Piet Battiau, Alain Charlet, (2011) VAT's next half century: Towards a single-rate system?, OECD Observer No 284, Q1 2011, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

efficient operation of the “invisible hand” as Adam Smith⁶⁴¹ called it. That would mean harmonisation of electronic commerce consumption taxes could result in a degree of self-regulation of online vendors to the degree that consumer satisfaction would be paramount as well as efficient return of taxes to the tax authorities where the customer of the online transaction is located. This can mainly be attributed to the competition pressure placed on online vendors and suppliers, especially where the tax rates are not affecting decisions on permanent establishment and VAT registration, keeping in the top of the supply and demand chain only efficient practices, good customer-friendly approaches and adequate and accurate tax return.⁶⁴²

Harmonisation does usually carry a notion of lack of jurisdictional autonomy; governments can also be apprehensive because adopting a new uniform approach may have an unprecedented impact on their economies and result in loss of revenue rather than the wanted increase in revenue collected.⁶⁴³ This is also connected to tax competition; an issue which, if left unattended and regulated efficiently, could result to unemployment and could also threaten the viability of online vendors, especially the smaller ones when faced with the big corporations and their online presence, and

⁶⁴¹ Rothschild E, (1994), Adam Smith and the Invisible Hand, *The American Economic Review* , Vol. 84, No. 2, Papers and Proceedings of the Hundred and Sixth Annual Meeting of the American Economic Association (May, 1994), pp. 319-322, Available at: <http://www.jstor.org/stable/2117851>

⁶⁴² Rothschild E, (1994), Adam Smith and the Invisible Hand, *The American Economic Review* , Vol. 84, No. 2, Papers and Proceedings of the Hundred and Sixth Annual Meeting of the American Economic Association (May, 1994), pp. 319-322, Available at: <http://www.jstor.org/stable/2117851>

⁶⁴³ Vernon K. Jacobs, Global Electronic commerce Taxation: International Tax Issues in Global Electronic commerce, <http://www.rpifs.com/ecommerce/>

eventually threaten the efficiency of public services.⁶⁴⁴ Fall in revenue caused by tax competition between two countries can result in the funding of their public sector falling. As Flassbeck argues, countries do not get wealthier by direct competition, as it is seriously counterproductive⁶⁴⁵; therefore setting at least the tax rates in a uniform manner will remove the potential of tax base erosion by fierce competition between economic cooperating states.

Without an integrated and well-designed tax system, online traders operating in several member states could have the problem of getting taxed more than one time. Goods and services should be allowed to move freely between the EU Member States, it being one of the basic foundations of the Union, and if that is not the case growth of businesses and online commerce can be discouraged⁶⁴⁶. The current system of VAT in the EU sets certain limits whereas it does not dictate that all Member States have the exact same tax rates⁶⁴⁷; it creates a standardised approach throughout the Member States, but at the same time it is allowing variations from State to State. This differential in the way of bringing all the tax systems under the same umbrella can be used for setting a common VAT for online sales, not just within the EU but also applicable for the US. If the two

⁶⁴⁴ Rothschild E (1994) Adam Smith and the Invisible Hand, *The American Economic Review*, Vol. 84, No. 2, Papers and Proceedings of the Hundred and Sixth Annual Meeting of the American Economic Association (May, 1994), pp. 319-322, Available at: <http://www.jstor.org/stable/2117851>

⁶⁴⁵ Flassbeck H. (1999) Employment, stability and efficiency: the essentials of European economic policy' in "Will EMU lead to a European economic government?" Centre for European Reform, Available at : <http://www.flassbeck.de/pdf/2000/Strategi.pdf>

⁶⁴⁶ Cockfield, A J. (2000) Transforming the Internet into a Taxable Forum: A Case Study in Electronic commerce Taxation." *Minn. L. Rev.* 85 (2000): 1171.

⁶⁴⁷ VAT rates, http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/

aforementioned major actors in electronic commerce decide to take a similar approach, that should be enough of an incentive for other countries to join in a more closely knit globalised forum.⁶⁴⁸

Overall, there is a need for a simplified tax system; one that could be applied with ease to numerous jurisdictions, which perhaps have a harmonised, but not unified, set of VAT rates and principles to apply them to. That should also carry well discussed principles of tax revenue distribution amongst the relevant countries to the transaction. Basu argues that multiple taxation of electronic commerce transactions can result in counteracting the convenience and potential price reduction consumers may find when purchasing online⁶⁴⁹. He then proceeds to say something we can use for guidance on taxing electronic commerce transactions should be taxes applicable to the traditional similar transactions and either keep it the slightly less or make it equal; this also connects to a valid argument that harmonisation in this area will also help keep compliance cost down for online vendors, simply because they will need to comply with less complicated and less in numbers VAT systems targeting electronic commerce tax. However, all the above reasons do not always apply and many consider harmonisation for taxes of electronic commerce a rather unrealistic target, also pointing out there are potential pitfalls with

⁶⁴⁸ Paris R, (2003) The globalisation of taxation? Electronic commerce and the transformation of the state, *International Studies Quarterly*, 47, 153-182

⁶⁴⁹ Basu, (2004) To tax or not to tax? That is the question. Overview of options of consumption taxation of electronic commerce, *The Journal of Information, Law and Technology (JILT)*. Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu/

harmonising and attempting to perhaps establish a VAT system for electronic commerce on a global perspective.

3.3 Why not harmonise?

One reason not to harmonise has already been mentioned, when this thesis was considering the reasons to harmonise; that reason is the matter of state sovereignty. It is understandable and easily evident that states would be concerned about the lack of total control within their boundaries, take decisions for their citizens without the need to consult another neighbouring or distant State, in the case of electronic commerce.⁶⁵⁰ Therefore, any harmonisation or attempt to uniformity would create a significant loss of the autonomy of the State, in the traditional sense of sovereignty. Considering the technological developments and the social development nowadays, sovereignty can be examined and analysed from a different prism, a more modern one, and global sovereignty. The argument could be that countries must retain control over their own tax systems because the power to levy taxes is central to national sovereignty and decision-making. On the other hand, Jayasuriya says *“the development of a global economy, rather than an international economy, and the associated reorganization of*

⁶⁵⁰ Azam, Rifat, (2012) Global Taxation of Cross Border Electronic commerce Income, Virginia Tax Review, Vol. 31, No. 4, 2012. Available at: <http://ssrn.com/abstract=2117022>

social power, has transformed this essentially territorial model of sovereignty” ⁶⁵¹.

Harmonisation of VAT of electronic commerce will not interfere with this principle in this modern perspective; what it does is emphasise is the global economy, which can be the playing field for a harmonised VAT for online sales.

Another reason why a proposed harmonised VAT may not appeal to all jurisdictions is the tax collection and the relation to public finances. McLure states that harmonising electronic commerce VAT can jeopardise a jurisdiction's financial autonomy, if the revenue is collected and spread out evenly.⁶⁵² Countries must retain control over their own tax systems because the power to levy taxes is central to national sovereignty and decision-making.⁶⁵³ Internet and technological developments have assisted to removing boundaries and with that the previous notion of defined legal status quo within a jurisdiction. One thing that should not go unmentioned is that tax is a way to express political consensus and democratic procedural elements⁶⁵⁴, as the New Zealand example indicates.

⁶⁵¹ Kanishka Jayasuriya, (1999) Globalization, Law, and the Transformation of Sovereignty: The Emergence of Global Regulatory Governance, 6 IND. J. GLOBAL LEGAL STUD. 425, 432–33

⁶⁵² Charles E. McLure Jr. (1988) State and Local Implications of a Federal Value-Added Tax, Tax Notes , Mar. 28, p. 1517

⁶⁵³ Gunther G. Schulze & Heinrich W. Ursprung,(1999) Globalisation of the Economy and the Nation State, 22 WORLD ECON. 295

⁶⁵⁴ Jeffrey Owens, Piet Battiau, Alain Charlet, (2011) VAT's next half century: Towards a single-rate system?", OECD Observer No 284, Q1 2011, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

Different states have different economic priorities: some may want low taxes to encourage enterprise while others, such as the UK, want higher taxes to pay for welfare provisions. The differing uses of taxation also constitute a hurdle to the further harmonisation of VAT. To an extent it reflects the citizens' view on the everyday implications of policies and fiscal decisions. New Zealand, a country that only recently introduced its own value added tax, the Goods and Services Tax (GST) in 1986, only did so after an extensive public consultation, in order for the political decision to reflect the public's decision, since the GST would be something impacting directly on the citizens.⁶⁵⁵ If the public opinion was negative, then the political ramifications would be devastating for the politicians as well as for relevant governmental policies.

Both the OECD⁶⁵⁶ and IMF⁶⁵⁷ have been keen on the introduction of VAT and their agencies have been active in promoting the benefits of a compatible VAT scheme, something obvious from the publications of both organisations. However, as it has been mentioned in relation to state sovereignty, it is not the easiest of tasks to introduce VAT to certain jurisdictions and thus achieve in creating a level playing field, in order to eventually have a much easier task when attempting a wider harmonisation for VAT of

⁶⁵⁵ Dickson, & White D, (2008) Tax Design Insights from the New Zealand Goods and Services Tax (GST) Model," Working Paper 60, Centre for Accounting, Governance, and Taxation Research, School of Accounting and Commercial Law, Victoria University of Wellington

⁶⁵⁶ Jeffrey Owens, Piet Battiau, Alain Charlet, (2011) VAT's next half century: Towards a single-rate system?, OECD Observer No 284, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

⁶⁵⁷ Norregaard J & Khan T, (2007) Tax Policy: Recent Trends and Coming Challenges, IMF Working Paper No. 07/274, Fiscal Affairs Department

electronic commerce. For instance, Eccleston⁶⁵⁸ makes the point that it would be rather difficult for an American politician to put VAT on the agenda as such an initiative would risk severe opposition and disapproval⁶⁵⁹. This further proves the reason for taxation, and specifically VAT, is directly linked to political will and especially when it comes to implementation of said tax, problems of political and economic nature can arise, and usually need to be considered before the tax is looked at all. The policy decisions relating to taxes, and specifically to consumption taxation or electronic commerce, do come with certain political approaches and perspectives too⁶⁶⁰, thus allowing for the differences in the tax systems and posing potential problems when an issue such as harmonisation is brought to discussion.

4. Maybe cooperation a better solution for the near future?

Harmonisation still seems to be far from realisation, but it is not an impossible aim. Considering it from more than one perspective, not just legal but also economic and political⁶⁶¹, and looking into most of the relevant literature, harmonisation of this area is

⁶⁵⁸ Eccleston R, (2007) *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia*, Edward Elgar

⁶⁵⁹ In United States this is also known as '*Ullman syndrome*' called after member of the Congress Al Ullman who proposed VAT twice (in 1979 and 1989) and who as a result was defeated from Ways and Means Committee which he was chairing, even though it was generally considered as one of the 'safest seats in Congress'(Eccleston,2007)

⁶⁶⁰ James M Bickley, (2005) VAT as a New Revenue Source, CRS Issue Brief for Congress, Congressional Research Service, Available at http://assets.opencrs.com/rpts/R41708_20110322.pdf

⁶⁶¹ See Paris R, (2003) The globalisation of taxation? Electronic commerce and the transformation of the state, *International Studies Quarterly*, 47, 153-182, ⁶⁶¹ Salter, (2001) Electronic commerce and International Taxation, *International Business Law: Electronic commerce and the impact of globalisation on the law*, New England Journal of International and Comparative Law Symposium, New England School of Law

being placed in the distant future, or even a more pessimistic view placing it in the unlikely future⁶⁶²! One solution to efficient cooperation, as a starting point at least, would be the use of the technology to facilitate and enhance cooperation, as well as allow a degree of self-regulation.⁶⁶³ That would permit online vendors to take part and offer a pragmatic perspective in shaping that framework⁶⁶⁴. Another way to facilitate and establish cooperation could be by utilising the technology, which made electronic commerce possible in the first place. That technological infrastructure with private infrastructure alongside could be a good union to collect and administer taxes. Also, this union could assist with the legislative or any kind of regulatory framework by detracting the main focus of the specifics and the idea that law or technology should operate alone and by illustrating in practice that the better formula could be with law and technology and the relevant conventions and policies in cooperation; all of these elements merely being just one of the important components to jointly form a successfully provision for a taxing scheme for VAT of electronic commerce.

⁶⁶² See Basu, (2004) To tax or not to tax? That is the question. Overview of options of consumption taxation of electronic commerce, The Journal of Information, Law and Technology (JILT). Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu/, Diedrich F, 'A Law of the Internet? Attempts to Regulate Electronic Commerce', 2000 (3) The Journal of Information, Law and Technology (JILT). Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2000_3/diedrich/

⁶⁶³ Diedrich F, (2000) A Law of the Internet? Attempts to Regulate Electronic Commerce, (3) The Journal of Information, Law and Technology (JILT). Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2000_3/diedrich/

⁶⁶⁴ Pastukhov O, (2009) Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on the International Taxation of Electronic commerce", Rutgers Computer and Technology Law Journal, Volume 36, Number 1

Understandably, it is not an ideal model and it has its disadvantages and difficulties. But, in comparison to the current regime and responses to electronic commerce challenges, this proposal will bring substantial progress. These benefits should and would contribute in overcoming the expected difficulties of accepting supranational taxation and infringement of state sovereignty. But, this revolutionary change in the international tax regime is needed in the revolutionary world of cross-border electronic commerce in the twenty-first century. Optimistic thinking brought amazing electronic commerce to the world and hopefully optimistic thinking will bring a better and more efficient tax regime for online commercial transactions. This proposal cannot become reality without evident willingness and significant forward thinking as well as patience. It is not something that could or would materialise in a very short timeframe, and both the US and EU should find a suitable and mutually beneficial middle ground; that middle ground having very positive implications from fiscal to social and technological perspectives.

5. Conclusion

This chapter tried to consider why harmonisation would be beneficial, if adopted for bringing together all compatible consumption taxes of electronic commerce. There are positive arguments to the case for harmonisation, but at the same time not without potential pitfalls. The current system has been criticized as economically distorting,

because it provides a tax incentive to purchase goods over the Internet rather than through conventional means. It also has been criticized as inadequate to meet states' and localities' revenue needs. On the other hand, it has been argued that if current rules were relaxed, it would be too burdensome for electronic merchants to comply with the different sales tax regimes of the 50 states and countless localities. Technical issues also would arise, such as where delivery would take place when a seller transmits a good electronically⁶⁶⁵. Thus, it is likely that a worldwide consensus will not develop at least until the world's nations are secure in their understanding of how the Internet will affect their economies. Federal action will be necessary for states and local authorities to collect sales and use taxes more vigorously. In the meantime, businesses will continue to interpret existing rules to their advantage, and state and local governments will continue to leave valuable sources of revenue untapped.

⁶⁶⁵ David L. Forst (1999) Old and New issues in the Taxation of Electronic Commerce 14 Berkeley Tech. L.J. 711

8. Conclusion

Contents

8. Conclusion	299
1. Summary of main points.....	301
2. Regulation; significant attempts so far	304
3. Policy and action for the future?	306

1. Summary of main points

The Internet has gone past its infantile stages⁶⁶⁶ and has constantly been growing. A big part of the Internet, electronic commerce, has also been developing significantly for individuals as well as businesses and States. This later development has brought exciting new ways of doing things, sometimes altering and thoroughly improving the shopping experience by providing another new platform for it. The internet managed to push boundaries and enable for electronic commerce the development, while enabling for

⁶⁶⁶ Pastukhov, O, (2010) Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on the International Taxation of E-Commerce, 36 Rutgers Computer & Tech. L.J. 1, Available at http://heinonline.org/HOL/Page?handle=hein.journals/rutcomt36&div=4&g_sent=1&collection=journals

the users the move forward from the traditional manner in which certain transactions took place previously. Nowadays purchasing a good or a service online is the norm rather than a novel idea, and purchasing something which could originate from a distant jurisdiction is not surprising.

This thesis looked into the development of electronic commerce and the implications this development brought about; especially focusing at the implications regarding consumption taxation. The sale of a product or service, whether it takes place online or in the shop, is a commercial transaction and should be taxed accordingly. The main argument of the thesis was that electronic commerce should be taxed and should not be differentiated from traditional commerce, as that could create significant imbalances and injustice for the people, businesses and States involved. The main premise of the thesis also raises jurisdictional matters; are taxation systems adequate to deal with the constantly growing number of online shoppers?

The internet has created certain challenges for the tax authorities. A tax is traditionally a principle which operates within specific boundaries and the relevant jurisdiction it was created and operates in. One of the challenges is the aspect of regulatory interference with Internet; should the State be able to tax or not just one State?⁶⁶⁷ The debate

⁶⁶⁷ Lessig, (2002) Code and Other Laws of Cyberspace, (now Code v2, 2007) , Also revisited the idea in Free Culture, 2004)

between Cyber libertarians, Cyber-sceptics and Cyber-realists is still on-going. Evidently, there is no reason to dictate not imposing taxes on a commercial transaction at this point in time⁶⁶⁸; it is a commercial transaction therefore it carries interest from the state and thus should be taxed. But how does the State tax? Is there the need to implement completely new and pioneering legislation for the internet? The opinion of the author is not necessarily, and it coincides with the opinion of Basu⁶⁶⁹, meaning the internet is merely a new stage on which current regulation can apply, perhaps with some adjustments. One aspect of major importance for the viability of electronic commerce as a competitor to traditional commerce, is the principle of neutrality, if the product is the same, the means by which you acquire it does not mean a different consumer experience.⁶⁷⁰ Other problems tax authorities may face include the anonymity an internet consumer may have behind the computer screen, difficulties in determining where the parties are actually located, especially if they use very contemporary software and hardware. One other aspect that arrived with the arrival of electronic commerce is the digitization of goods and services, i.e. downloading antivirus software instead of buying the cd in the box.⁶⁷¹

⁶⁶⁸ Rowland D, (1998) Cyberspace - A Contemporary Utopia?, The Journal of Information, Law and Technology (JILT), (3), <http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/1998_3/rowland/>

⁶⁶⁹ Basu Subhajit (2004), 'To tax or not to tax? That is the question? Overview of Options in Consumption Taxation of Electronic commerce', (1)The Journal of Information Law and Technology(JILT), http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu

⁶⁷⁰ Doernberg R et al, (2001), Electronic Commerce and multijurisdictional Taxation, 33

⁶⁷¹ Tillinghast David, (1996) The impact of the internet on the taxation of Informational Transactions, 50 Bull. Int. Fisc. Doc. 524

VAT is the main tax examined in the thesis due to its nature and applicability in even small in value transactions. The consumer can be negatively affected, if there is lack of a simple and efficient framework around consumption tax, and can also be affected when there is a problematic debate as to whether a digitised product being digitised is characterised as good or service.⁶⁷² The 4 Smithsonian canons are providing very good insight and guidance on how to attempt the creation of a new tax and what framework that tax requires to efficiently operate in its designated locality. Despite the fact Smith wrote his 4 canons in the beginning of 1900s⁶⁷³, they still offer valuable assistance to regulators, even when the premise is designing a tax to apply to electronic commerce.

2. Regulation; significant attempts so far

Governments remained still for a long period of time when electronic commerce started developing⁶⁷⁴, and for that reason organisations such as the WTO and the OECD took the informal role of leading the publication of research relevant to Internet and electronic commerce, and especially in regards to the implications of taxation. In 1998

⁶⁷² Directive 97/7/EC, Distance Selling Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997L0007:EN:NOT>

⁶⁷³ Smith, Adam. 1904, *An Inquiry into the Nature and Causes of the Wealth of Nations*. Edwin Cannan, ed. 1904. Library of Economics and Liberty. (Retrieved December 6, 2012 from the World Wide Web: <http://www.econlib.org/library/Smith/smWN.html>)

⁶⁷⁴ Pastukhov, O, (2010) *Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on the International Taxation of E-Commerce*", 36 Rutgers Computer & Tech. L.J. 1 Available at http://heinonline.org/HOL/Page?handle=hein.journals/rutcomt36&div=4&g_sent=1&collection=journals

OECD published the Ottawa Taxation Framework Principles, which were meant to be the basis for any subsequent regulation from the EU or the US.⁶⁷⁵ These principles were the starting point for Council Directive 2002/38/EC as well as the Internet Tax Freedom Act; that raises a point as they are looking at opposite directions. This brings into the discussion political and economic aspects, which are present when tax policy is to be created or revised, and brings the factual realisation that US took a more “hands off” approach, while EU, perhaps seeing it a starting the race first and gaining an advantage, decided to do the opposite and impose regulation by means of the aforementioned Directive. In the US, due to the lack of Federal coordination mainly, the Streamlined Sales and Use Tax project was put in place to enable a better cooperation between states and close any gaps in the tax regulations in relation to electronic commerce and out-of-state online vendors. It is a very well-thought and efficient project, but it cannot be utilised to its full potential as it is deemed to carry constitutional restraints, due to some of its elements contrasting aspects of the Quill decision.

In the EU the development of regulation around Internet taxation and specifically consumption taxes, such as VAT, has been more active than in the US, with the very significant Directive 2002/38/EC, which has subsequently been extended to a permanent nature currently. The EU has been, more active and efficient as they

⁶⁷⁵ OECD, (2003) Report on the Implementation of the Ottawa Taxation Framework Conditions, <http://www.oecd.org/tax/taxadministration/20499630.pdf>

recognised the revenue potential in online sales, and also identified the nature of online sales being another type of commercial activity, which needs taxing for the jurisdiction in which the online seller is registered. Even though the EU and the US currently have adopted different policies, the Streamlined Sales and Use Tax Project seems appears to be sharing the perspective and principles of the VAT scheme and potentially, a hopeful look into the future maybe, make the first step towards harmonisation of these two jurisdictions. The term harmonisation does not mean a total unification, everything exactly the same for both the EU and the US, but it means an approximation and compromise to similar principles, even if not necessarily the exact same ones.

3. Policy and action for the future?

This last part being the concluding remarks of the thesis, what should be reiterated is the hope of realising an international scheme of VAT, or similar; due to the inherent nature of Internet having no boundaries, such a development will enhance even further the development of electronic commerce. It is by no means an easy approach to implement, or an easy task to consider, but it may mean taking the consumption taxation principles back to the basics and identifying the common threads on which to create a homogenous scheme applicable to more than one jurisdictions. It is vital for law, commerce and technology, as well as the policies of developing countries participate to this exercise, for the result to be flexible, accurately applicable and

efficient. On the other hand, a more pessimistic potential is each state to try and regulate its own “internet” and impose just jurisdictional taxes on electronic commerce. This could lead to the inevitable result of double taxation, frustration for online sellers and consumers, and potentially damaging the further development of electronic commerce.

The Internet will keep presenting challenges to regulatory aspects, such as taxation for the purpose of this thesis, as technology develops even further. As long as the relevant legal framework is not too slow to follow and maybe even carefully calculate, then it will not merely assume a reactionary role and will be possible to provide an efficient regulatory framework for consumption taxation for online sales. A reactionary role, will merely delay the expected and customary which is to tax, as efficiently as possible, any commercial activities, whether they are taking place online or through traditional channels. The States need revenue to provide for the citizens and if revenue is not collected efficiently and adequately, the State’s welfare provision and provisions for education and other important aspects cannot be supported. Realistically that is how a State needs to operate; revenue should be providing the means and creating the balance for a significant part of the labour and service provisions to the citizens, and that simple justification states why there is an expectation for electronic commerce to be taxed. According to folklore, Michael Faraday, who discovered the principle of

electromagnetic induction, was asked by a British politician what use electricity might have. Faraday replied, "I do not know what it is good for. But of one thing I am quite certain--someday you will tax it." This quotation is most probably a myth, but even so there is significant truth therein. Like electricity, that was eventually taxed, online commerce should be taxed; however it should be taxed fairly and efficiently and what should be encouraged is for tax authorities to make the most of the technology and infrastructure of Internet to implement successfully the necessary principles. The European Union has taken some steps which are concise and efficient, and with similarly encouraging attempts by the US, such as the Marketplace Fairness Act, it appears that there is momentum towards the right direction; nonetheless it will still require consensus of a number of jurisdictions to establish a working model of a harmonised taxation regime.

Bibliography

Books

Basu Subhajit, (2007) Global Perspectives on Electronic commerce Taxation Law, Ashgate

Brownlee (2004) 'Federal Taxation in America: a short history', 2nd ed, Cambridge,

Cady, J.F (1985), "Marketing strategies in the information industry", in Buzzell, R.D (Eds), Marketing in the Electronic Age, Harvard Business School Press, Boston, MA,

Craig & De Burca, (1998) EU Law, (Oxford University Press

Craig William, (2001) Taxation of electronic commerce, Butterworths Tolley.

Dalton Hugh (1922), Principles of Public Finance, 17th Impression - 1948, Routledge & Keegan Paul Limited

Davies (1998), Computer Program Claims, EIPR 429

Doernberg, R.L., Hinnekens, L., Hellerstein, W. & Li, J. (2001), Electronic Commerce and Multijurisdictional Taxation, Kluwer Law International, The Hague

Easson, AJ (1980) "Tax Law and Policy in the EEC" Sweet & Maxwell

Frieden Karl, (2000) 'Cyber taxation: The Taxation of Electronic commerce' CCH Incorporated,

Hedley & Aplin (edited by) (2004) IT & electronic commerce, OUP

Hedley, (2006) The Law of Electronic Commerce and the Internet in the UK and Ireland, Cavendish

Heidemann, (2007), "Methodology of Uniform Contract Law" Springer

Hickey Julian JB, (2000) Internet Business Commerce and Tax, Jordan

Kenneth Kraemer et al eds. (2006), Global Electronic Commerce: Impacts of National Environment and policy, Cambridge

Klun Maja, Decman Mitja, Tina Jukic, (2011), The Proceedings of the 11th European Conference on eGovernment: ECEG-2011 (University of Ljubljana, Slovenia), Academic Publishing International Ltd (16-17 Jun 2011)

Lamb, Lymer (2005) Freedman and James, Taxation, OUP.

Lessig, (2002) Code and Other Laws of Cyberspace, Basic Books

Lymer A. (2005), Taxation in an Electronic World, (in Lamb, Lymer, Freedman & James (editors) 2005 Taxation: An Interdisciplinary Approach to Research, OUP

Lymer & Hasseldine, (2005) The international Taxation System, Kluwer
Metcalf. (1999) "Consumption Taxation" Encyclopaedia of Taxation and Tax Policy. Ed. Cordes, J., R. Ebel, and J. Gravelle. Urban Institute Press, 1999

McDaniel, Hugh J. Ault, James R. Repetti, (2005) Introduction to US International Taxation (Aspen Student Treatise Series)

McKay, J. and Marshall, P. (2004) Strategic Management of e-Business. John Wiley & Sons, Brisbane

Mclure Ch.(1999) International Tax and Public Finance, 6, 193–224 1999 Kluwer Academic Publishers, Boston.

Morse & Williams (2004) Davies: principles of tax law. Sweet & Maxwell; 6th Ed

Murray (2007) The Regulation of cyberspace, Routledge-Cavendish

Musgrave, R. A., Musgrave, P. B. (1973) Public Finance in Theory and Practice, McGraw-Hill Book Company.

Nonna Noto, (2003) Extending the Internet Tax Moratorium and Related Issues, in Internet Taxation 18, 36 (Albert Tokin Ed) Novinka Books

Ogley, (1996) Principles of International Tax, Interfisc Publishing

Ogus, (1994) Regulation – legal form and economic theory, Hart

Picciotto S, (1992), International Business Taxation: A Study in the Internationalization of Business Regulation, Greenwood Press

Plofker Kim, (2009) Mathematics in India, Princeton University Press

Reed & Angel, (2007) Computer law: the law and regulation of information technology, OUP Oxford, 6th Ed

Sampson William D, (1998) The international taxation system - History of taxation, The place of supply in European VAT

Shepard Ashman Morgan, David A. Wells, (1911) The History of Parliamentary Taxation in England

Smith, Adam. (1904), An Inquiry into the Nature and Causes of the Wealth of Nations. Edwin Cannan, ed. 1904. Library of Economics and Liberty. (Retrieved December 6, 2012 from the World Wide Web:
<http://www.econlib.org/library/Smith/smWN.html>)

Smith A. (1776), An inquiry into the nature and the cause of the Wealth of Nations, Book 5, Chapter 2 – part 2 “of Taxes”,

Turban et all, (2004) Electronic Commerce and Update Package, Prentice-Hall,

Zeller Bruno, (2007) “CISG and the unification of international trade law” Routledge – Cavendish,

Journal articles

Aaron Lukas, (2012) "Tax Bytes: A Primer on the Taxation of Electronic Commerce." <http://www.cato.org/publications/trade-policy-analysis/tax-bytes-primer-taxation-electronic-commerce?print>

Alley and Bentley. (2005) "A remodelling of Adam Smith's tax design principles" Bond University Faculty of Law, E-publications
http://epublications.bond.edu.au/law_pubs/45

Alimo N. And Scheider G. (2011), Proceedings of the Academy of Legal, Ethical and Regulatory Issues, Volume 15, Number 1

Azam Rifat, (2007) Electronic commerce Taxation and Cyberspace Law: The Integrative Adaptation Model, , Virginia Journal of Law & Technology Association, SUMMER 2007 VOL. 12, NO. 5

Azam, Rifat, (2012) Global Taxation of Cross Border Electronic commerce Income (July 25, 2012). Virginia Tax Review, Vol. 31, No. 4. Available at:
<http://ssrn.com/abstract=2117022>

Bakar WN Wan, (2011), Mathematics in the Holy Quran, Journal of Academic Minds

Bankman J. & Weisbach D (2005) The superiority of an ideal consumption tax over an ideal income tax,

Basu S, (2004), "To tax or not to tax? That is the question. Overview of options in consumption taxation of electronic commerce", 2004 (1) The Journal of Information, Law and Technology, JILT
http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2004_1/basu/

Basu S, (2002) 'European VAT on Digital Sales', The Journal of Information, Law and Technology (JILT) 2002 (3) Available at:
http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2002_3/basu/

Basu (2003) "Relevance of Electronic commerce for Taxation: an Overview", Global Jurist Topics: Vol.3: No. 3, Article 2.

<http://www.bepress.com/gj/topics/vol3/iss3/art2>

Basu. (2003) "Implementing Electronic commerce Tax Policy (Consumption Taxation)" 18th Annual BILETA Conference. Queen Mary, University of London. Apr. 2003. Available at: <http://works.bepress.com/subhajitbasu/35>

Benkler, Yochai (2000) "From Consumers to Users: Shifting the Deeper Structures of Regulation Toward Sustainable Commons and User Access," Federal Communications Law Journal: Vol. 52: Issue. 3, Article 9.

Bickley, 2005 "VAT as a New Revenue Source", CRS Issue Brief for Congress, Congressional Research Service," June 2005, Available at http://assets.opencrs.com/rpts/R41708_20110322.pdf

Stephen Bill (2004). "Future changes to the 6th VAT Directive", 1/06/2004, (Head of the VAT and other turnover taxes unit), http://ec.europa.eu/taxation_customs/resources/documents/article_on_future_changes_of_sixth_vat_directive-en.pdf (Mr, Head of the VAT and other turnover taxes unit).

Bird and Zolt. (2003), Introduction to Tax Policy Design and Development. Practical Issues of Tax Policy in Developing Countries, World Bank, April 28-May 1, 2003

Bittker, Boris I. (1975), Tax Reform and Tax Simplification, 29 U. Miami L. Rev. 1 (1974-1975) Tax Reform and Tax Simplification.

Block, W., & Portillo, J. E. (2012). Negative Effects of US Taxation. Studies in Economics and Finance, 29(2), 1-1

Bolkestein Frits, (2001) "Harmful tax competition, VAT on digital deliveries, taxation of savings, Address to European American Business Council, Washington D.C., May 9th 2001

Budnitz M. E., (1998), Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate, 49 S.C. L. Rev. 847 (1998)

Brodersen, (1997) "Taxation of Cross-border Electronic Commerce: Germany" 25(4) *Inter Tax International Tax Review* 133.

Boodman, (1991) "The myth of harmonisation of Laws" 39 AJCL 699 1991

Brooks, Barrett (2005) Electronic commerce and States Sales Tax, *Journal of State Taxation*, 24, 2 pp 47-49

Carlson R, (2004), 'A brief history of property tax', *IAAO Conference Proceedings on assessment Administration*

Charles (2005) Taxing the Internet-The state's next frontier, *Journal of State Taxation*

Chan Clayton, (2000) Taxation of Global Electronic commerce on the Internet: The Underlying Issues *and Proposed Plans*, 9 MINN. J. GLOBAL TRADE 233, 255; <http://www.winthrop.com/portals/0/pdf/claytonchan.pdf>

Charlet A & Owens J, (2010) "An International Perspective on VAT," OECD: Tax Notes International, Available at www.oecd.org/dataoecd/47/45/46073502.pdf.

Chatfield, A.T. (2009) "Public Service Reform through e-Government: a Case Study of 'e-Tax' in Japan." *Electronic Journal of e-Government* Volume 7 Issue 2, (pp. 135 - 146), available online at www.ejeg.com

Chen, C., & Huang, E. (2009), A Study on Taxpayers' Willingness to Use Self-Service Technology-Based Online Government Services. *Journal of Electronic Commerce in Organizations (JECO)*, 7(2), 44-66.

Clark & Dilnot (2002) Long-Term Trends in British Taxation and Spending, <http://www.ifs.org.uk/bns/bn25.pdf>

Cline, R. J., & Neubig, T. S. (1999). Masters of complexity and bearers of great burden: the sales tax system and compliance costs for multistate retailers. Ernst & Young Economics Consulting and Quantitative Analysis, 8.

Cnossen, S. (2001) Tax policy in the European Union: a review of issues and options. FinanzArchiv/Public Finance Analysis, 466-558.

Cnossen S. (2002) Tax Policy in the European Union (August 2002). CESifo Working Paper Series No. 758. Available at SSRN: <http://ssrn.com/abstract=340905>

Cnossen, S. (2003). How much tax coordination in the European Union?. International Tax and Public Finance, 10(6), 625-649.

Cockfield Arthur, (2005) The rise of the OECD as informal “world tax organisation” through national responses to electronic commerce tax challenges, 2005, 8 Yale J.L. & Tech. 138 2005-2006

Cockfield, (1999) Balancing National Interests in the Taxation of Electronic Commerce Business Profits, 74 TuL. L. REv. 133 ;

Cockfield, (2002) Designing Tax Policy for the Digital Biosphere: How the Internet is Changing Tax Laws, vol. 34 Connecticut Law Review pp. 333-403

Cockfield, (2002) *The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles*, INT’L BUREAU OF FISCAL DOCUMENTATION BULL. 606, 613

Cockfield, (2004) Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test, Tax Notes International, Vol 33, No 7

Cockfield, A J. (2000) "Transforming the Internet into a Taxable Forum: A Case Study in Electronic commerce Taxation." Minn. L. Rev. 85 : 1171.

Collier, P. (2009). The political economy of fragile states and implications for European development policy. Background paper for European Report on Development. <http://erd.eui.eu/media/Collier.pdf>

Collin Lau, et al, (2003) 'From Electronic commerce to E-Business Taxation' Asia-Pacific Tax Bulletin, p.7.

Cordell, A & J. Ide (1994) "The New Wealth of Nations: Taxing Cyberspace", paper prepared for annual meeting of the Club of Rome, November, Buenos Aires: Between the Lines Publishers

Coy Peter, (1998) You aint seen nothing yet, Business Week, June 22

Davies LJ (1998) "A Model for Internet Regulation", <http://www.scl.org>

Deloitte & Touche (1999) "Establishing a Framework to Evaluate Electronic commerce Tax Policy Options", UC Berkeley

Devereux, M. P. (2004). Debating proposed reforms of the taxation of corporate income in the European Union. International Tax and Public Finance, 11(1), 71-89

Dibbell Julian (2001) "A rape in Cyberspace; how an evil clown, a Haitian trickster spirit, two wizards, and a cast of dozens turned a database into society" 1993, Village Voice (http://www.juliandibbell.com/texts/bungle_vv.html)

Dickson, & White D, (2008) "Tax Design Insights from the New Zealand Goods and Services Tax (GST) Model," Working Paper 60, Apr. 2008, Centre for Accounting, Governance, and Taxation Research, School of Accounting and Commercial Law, Victoria University of Wellington

Diedrich F, (2000) 'A Law of the Internet? Attempts to Regulate Electronic Commerce', 2000 (3) The Journal of Information, Law and Technology (JILT). Available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/2000_3/diedrich/

Doernberg, R., Hinnekens, L., Hellerstein, W., & Li, J. (2000). Electronic Commerce and Multijurisdictional Taxation (2001). Karl Frieden, Cybertaxation: The Taxation of E-Commerce.

Drenkard Scott, (2011), Tax Foundation Fiscal Fact No. 284: Ranking State and Local Sales Taxes, <http://taxfoundation.org/article/ranking-state-and-local-sales-taxes-1>

Dresnera, Dunneb, Clinchb, Beuermannnc (2006)'Policies for Ecological Tax Reform: Assessment of Social Responses' (PETRAS), Energy Policy, Volume 34, Issue 8, May 2006, Pages 895–904

Eccleston R, (2007), "Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia", Edward Elgar, 2007

Emota (2012) "Europe Confirmed as Leader in Global electronic commerce" 01 June 2012, <http://www.imrg.org/ImrgWebsite/User/Pages/Press%20Releases-IMRG.aspx?pageID=86&parentPageID=85&isHomePage=false&isDetailData=true&itemID=7685&specificPageType=5&pageTemplate=7>

Evans Kelly, (2010) "How America Now Shops: Online Stores, Dollar Retailers (Watch Out Walmart)," The Wall Street Journal, March 23

Fagan, (2001) *Taxation of Electronic Commerce: Avoiding an Inroad Upon Federalism*, 49 Drake L. Rev. 465, 469

Flassbeck H. (1999) "Employment, stability and efficiency: the essentials of European economic policy' in "Will EMU lead to a European economic government?" Centre for European Reform, 1999, Available at: <http://www.flassbeck.de/pdf/2000/Strategi.pdf>

Forst, David L. (1999) Old and New Issues in the Taxation of Electronic Commerce 14 Berkeley Tech. L.J. 711

Fox William E., (2002), 'History and Economic Impact' University of Tennessee, <http://cber.bus.utk.edu/staff/mnmecon338/foxipt.pdf>

Fredriksson, (2013), "Electronic commerce and Development Key Trends and Issues", Workshop on Electronic commerce, Development and SMEs – UNCTAD, 8-9 April 2013 WTO, Geneva, Switzerland

Gelleny, Ronald D., and Matthew McCoy. (2001) "Globalization and government policy independence: The issue of taxation." *Political Research Quarterly* 54.3: 509-529.

Giampaolo Bella, Rosario Giustolisi, Salvatore Riccobene, (2011) Enforcing privacy in electronic commerce by balancing anonymity and trust, *Computers & Security*, Volume 30, Issue 8, November 2011, Pages 705-718, (<http://www.sciencedirect.com/science/article/pii/S0167404811001052>)

Gibbons,(1997) No Regulation, Government Regulation, or Self-Regulation: Social Enforcement or Social Contracting for Governance in Cyberspace, 6 *CORNELLJ.L. & PUB.POL* 475 (1997);

Gibbons William J., (1956) Tax Effects of Basing International Business Abroad, (May, 1956), *Harvard Law Review* , Vol. 69, No. 7 pp. 1206-1249

Glenn P, (1993) "Harmonisation of Law, Foreign Law and Private International Law", *European Review of Private International Law* 1

Golder, P.N, Tellis, G.J (1993), "Pioneer advantage: marketing logic or marketing legend", *Journal of Marketing Research*, Vol. 30 pp.158-70.

Goldsmith, Against Cyber anarchy, (2003) 65 *U. CHI. L. REV.* 1199 (1998); Kenney C, "The internet and economic growth in less-developed countries" *Oxford Development Studies*, Vol. 31, No. 1

Goldsmith, (1998) The Internet and the Abiding Significance of Territorial Sovereignty, 5 *IND. J. GLOBALLEGALSTUD.* 475

Grapperhaus (1998) 'Tax Tales From the Second Millennium (Taxation in Europe (1000 to 2000) the united states of America (1765 to 1801) and India (1526 to 1709))' *IBDF*

Grau Jeffrey, (2009) Electronic commerce in a recession: The impact on Consumers and Retailers, *eMarketer*

Genschel, Philipp (2005) 'Globalisation and the Transformation of the Tax State' *European Review*, Vol, Supp.No. , 53-71

Gulick P. Greg, (2001) The Internet's Impact on State Tax Systems, 33 URB. LAW. 479, 495

Gunther G. Schulze & Heinrich W. Ursprung, (1999) Globalisation of the Economy and the Nation State, 22 WORLD ECON. 295

Hale Kathleen, McNeal Ramona, (2011) Technology, politics, and electronic commerce: Internet sales tax and interstate cooperation, Government Information Quarterly, Volume 28, Issue 2, April, Pages 262-270
(<http://www.sciencedirect.com/science/article/pii/S0740624X10001449>)

Hardestey, David (2000), 'Europe Proposes New Taxes on Non-EU Sellers', 18th June 2000, Electronic commerce Tax News

Hardesty, (2000) Taxation of Electronic commerce: Recent Developments, 618 PLI/PAT 177

Hargitai, (2001) Value Added Taxation of Electronic Supply of Services within the European Community, LL.M. Harvard Law School, Jean Monnet Working Paper 13/01

Hellerstein W, (2002) Electronic Commerce and the Challenge for Tax Administration, 2002, Seminar on Revenue Implications of Electronic commerce on Development, Committee on Trade and Development, WTO, Geneva

Hardesty, (2000c) 'EU Continues Efforts to Tax Digital Products', E- Commerce Tax News, 22 October 2000, <http://www.ecommercetax.com>

Hellerstein W (2002), Electronic commerce and the challenge for tax administration. UN, 2001.

Hellerstein W. And Gillis T. H. (2010) The VAT in the European Union, April 26 2010, Tax Analysts 2010, <http://taxprof.typepad.com/files/127tn0461.pdf>

Ho Daniel, Wong Brossa, Lau Alex, (2008) E-business in a globalising world: Hong Kong legal and tax perspectives, Company Lawyer, 29(3)

Holmes David, (2001) "Tax administrations in an electronic world", conference, Montreal, 2001. (See: www.ae-tax.ca/langselect.html Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions, OECD, 2001.)

Horn Anita (2001) Internet Transaction Taxes: The Need for Jurisdictional Integration, 9 COMMLAW CONSPECTUS 29

Hugh Dalton, (1922), Principles of Public Finance, 17th Impression - 1948, Routledge & Keegan Paul Limited

Ivinson Jonathan, (2004) Overstepping the boundary - how the EU got it wrong on electronic commerce, Computer and Telecommunications Law Review, 2004 (10-4)

Ivinson, Jonathan (2003) Why the EU VAT and Electronic commerce Directive Does not Work International Tax Review International Tax Review, 2003

Jacobs, J. P., Ligthart, J. E., & Vrijburg, H. (2010) Consumption tax competition among governments: Evidence from the United States. International Tax and Public Finance, 17(3), 271-294.)

Johnson Carrie A. and Tesch Brian, (2007) "US eCommerce: 2005 to 2010--A Five-Year Forecast and Analysis of US Online Retail Sales", September 14, 2005, at <http://www.forrester.com/Research/Document/Excerpt/0,7211,37626,00.html> [Accessed December 19, 2007]

Johnson D and Post D (1998) The New 'Civic Virtue' of the Internet. First Monday, 3(1).

Jones Reilly (1996) "A critique of Barlow's 'A Declaration of Independence of Cyberspace'", 1996, Extropy#17 Vol.8 (2)

Jose Manuel L and Moore, Charles K. (1998) The development of Taxation in the Bible: Improvements in counting, measurement and computation in the ancient middle east, The Accounting Historians Journal, Vol. 25, No. 2 (December '98)

Josten, (1999) “Issues in Search of Answers: Electronic commerce Taxation”
Submission to the Advisory Commission on Electronic Commerce

Kamarulzaman, Y., & Azmi, A. A. C. (2010) Tax E-filing Adoption in Malaysia: A
Conceptual Model. Journal of E-Government

Kamlesh T. Mehta & Vivek Shah, (2001) Electronic commerce: The Next Global
Frontier For Small Businesses, The Journal for Applied Business Research, Vol 17,
No 1

Kanishka Jayasuriya, (1999) Globalization, Law, and the Transformation of
Sovereignty: The Emergence of Global Regulatory Governance, 6 IND. J. GLOBAL
LEGAL STUD. 425, 432–33

Kirchgässner, G., & Pommerehne, W. W. (1996). Tax harmonization and tax
competition in the European Union: Lessons from Switzerland. Journal of Public
Economics, 60(3), 351-371.

Kobrin Stephen, (2001) ‘Territoriality and the Governance of Cyberspace’, Vol. 32,
No. 4 Journal of International Business Studies, pp. 687-704.

Kohl, (1999) Legal Reasoning and Legal Change in the Age of the Internet – Why
the Ground Rules are still Valid, International Journal of Law and Information
Technology 7(2), pp123-151, Available at
<http://ijlit.oxfordjournals.org/content/7/2/123.full.pdf1999>

Kobrin (2001) Territoriality and Governance of Cyberspace, Journal of
International Business Studies, Vol.32

Kratochvill and Sansone, (2007) Too Many Grandfathers Spoil the Broth: The
Failure of the Internet Tax Non-discrimination Act?, Tax Analysts ‘07,
<http://www.mofo.com/files/Publication/7a5636f9-b6fb-41f0-a870-086eff2a823f/Presentation/PublicationAttachment/5286c4eb-bfef-4620-b6e8-0e18b9e034e9/071001StateTaxNotes.pdf>

Krensel, (2004) “VAT Taxation of Electronic commerce; under special
consideration of the 6th EU VAT Directive”, University of Cape Town

Laguna, J.D. (2002) International Trends: Sales, Use and Consumption Taxation of Electronic commerce, Revista e-Mercatoria Vol 1, No 1, Universidad Externado de Colombia

Langdon. (1997) "Cyber libertarian myths and the prospects for community." ACM SIGCAS Computers and Society 27.3: 14-19.

Lejeune & Mesdom, (2006) "The shape of things to come? Significance of new EU implementing Regulation", Tax Planning International, January '06

Lemley, (2003) Place and cyberspace, 91 Calif LR 521

Lessig, (1998) The laws of Cyberspace, available at http://cyber.law.harvard.edu/works/lessig/laws_cyberspace.pdf

Li Jinyan, (2003) International Taxation in the Age of Electronic Commerce: A Comparative Study, Toronto: Canadian Tax Foundation, 509

Lim, Lisa, (2011) "Applicability of VAT in the United States", The Contemporary Tax Journal. Paper 14. http://scholarworks.sjsu.edu/contemp_tax/14

Maguire S. and Noto A. N, (2006) Congressional Research Service, Report for Congress RL33261, Internet Taxation: Issues and Legislation in the 109th Congress

Mazero M, (2007) Making the ITFA permanent could lead to a substantial revenue loss for states and localities, Centre on Budget and Policy Priorities, <http://www.cbpp.org/files/7-11-07sfp.pdf>

Mellahi Kamel, Michael Johnson, (2000) "Does it pay to be a first mover in ecommerce? The case of Amazon.com", Management Decision, Vol. 38 Iss: 7, pp.445 – 452

McCreadie Karen (2009), Adam Smith's The Wealth of Nations: A modern-day interpretation of an economic classic: A Modern-day Interpretation of a True Classic, Infinite Ideas

McGaffrey, (2004) Wisconsin Tax Policy within a Federal System, 88 MARQ. L. Rev. 93, 99-100

McIntyre-O'Brien, R, (2003) 'Is there such a thing as Cyberlaw'? 11 ISLR 118. 118

McLure Jr, (1997) Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws, New York University School of Law Tax Law Review

McLure (2003) The Value Added Tax on Electronic Commerce in the European Union, International Tax and Public Finance, Volume 10, Issue 6, pp 753-762

McLure, Jr., (1992) "The Political Economy of Tax Reforms and Their Implications for Interdependence: United States," NBER Chapters, in: The Political Economy of Tax Reform, NBER-EASE Volume 1, pages 97-116, National Bureau of Economic Research, Inc.

McLure Jr., (1988) "State and Local Implications of a Federal Value-Added Tax," Tax Notes, p. 1517

Musgrave, Peggy B. (2006) "Combining Fiscal Sovereignty and Coordination." THE NEW PUBLIC FINANCE: 167

Musgrave R.A. & Musgrave , (1989) Public finance in theory and practice, 5th ed, McGraw-Hill

Nehaluddin Ahmad (2008) The tax net and the challenges posed by electronic commerce: a critical examination, Computer and Telecommunications Law Review

Nellen, (2006) Presentation at the 2006 Annual Meeting of the CA Tax Bar & CA Tax Policy Conference: Lurking Electronic commerce Taxation Issues, at I, available at http://www.cob.sjsu.edu/nellen_a/TaxReform/ECTaxIssues11-06.pdf

Nellen, (2001) 'Electronic commerce: To Tax or Not to Tax? That is the Question ... Or Is It?', Computer and Technology Law Conference", San Francisco

Norregaard J & Khan T, (2007) "Tax Policy: Recent Trends and Coming Challenges", IMF Working Paper No. 07/274, Fiscal Affairs Department

Oduntan, Olugbemi Adebayo, (2010) Taxation of Electronic Commerce: Prospects and Challenges for Nigeria. <http://ssrn.com/abstract=1697998> or <http://dx.doi.org/10.2139/ssrn.1697998>

Omar, Kwun & Bhutta, (2008) The Impact of Electronic commerce tax policy on State and Local Government Revenue, <http://www.swdsi.org/swdsi08/paper/SWDSI%20Proceedings%20Paper%20S150.pdf>

Owens Jeffrey, Piet Battiau, Alain Charlet, (2011) "VAT's next half century: Towards a single-rate system?" OECD Observer No 284, <http://www.oecdobserver.org/news/fullstory.php/aid/3509>

Pastukhov, O, (2010) "Going Where No Taxman Has Gone Before: Preliminary Conclusions and Recommendations Drawn from a Decade of Debate on the International Taxation of Electronic commerce", 36 Rutgers Computer & Tech. L.J. 1 '09-'10, Available at http://heinonline.org/HOL/Page?handle=hein.journals/rutcomt36&div=4&g_sent=1&collection=journals

Panagariya Arvind, (2000) Electronic commerce, WTO and Developing Countries, Policy Issues in International Trade and commodities; Study Series 2, UN

Perritt, Jr., (1997) Cyberspace Self-Government: Town Hall Democracy or Rediscovered Royalism? 12 BERKELEYTECH. L.J. 413

Rabkin J. And Eisenach J, (2009) The U.S. Abandons the Internet, (Wall Street Journal, October '09) Available at <http://online.wsj.com/article/SB10001424052748704471504574446942665685208.htm>

Raymond De Roover, (1955) Scholastic Economics: Survival and Lasting Influence from the Sixteenth Century to Adam Smith, The Quarterly Journal of Economics , Vol. 69, No., pp. 161-190.

Reese, (2003) Does the Streamlined Agreement Signal the End of Quill in the Area of Electronic commerce? 29 ST. TAX NOTES 639, 648

Reidenberg J (1996) "Governing Networks and Rule-making in Cyberspace", 45 Emory Law Journal 911.

Reidenberg J (1998) "Lex Informatica; the formation of information policy rules through technology", 76 Tex L Rev 553

Reuven S. Avi-Yonah (1997) International Taxation of Electronic Commerce, 52TAX L. REv. 507;

Rohlfing, Ingo. and Rixen, Thomas (2004) "Bilateralism and Multilateralism: Institutional Choice in International Cooperation. The Examples of International Trade and Taxation" Paper presented at the annual meeting of the American Political Science Association, Hilton Chicago and the Palmer House Hilton, Chicago, IL, Available at http://www.allacademic.com/meta/p59928_index.html

Roland P. (2003) "The globalization of taxation? Electronic commerce and the transformation of the state." *International Studies Quarterly* 47.2: 153-182.

Roose, Eric N. (1998) "Global Taxation of Electronic Commerce", 4 Asia-Pacific Tax Bulletin 7, pp. 248-259.

Rhoads C. (2009) U.S. Eases Grip Over Web Body, Wall Street Journal, October 2 '09, Available at <http://online.wsj.com/article/SB125432179022552705.html>

Rothchild, J. (1999) Protecting the Digital Consumer: The Limits of Cyberspace Utopianism. Indiana Law Journal, 74(3). Chicago. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139452

Rothschild E. (1994), "Adam Smith and the Invisible Hand", The American Economic Review , Vol. 84, No. 2, Papers and Proceedings of the Hundred and Sixth Annual Meeting of the American Economic Association, pp. 319-322, Available at: <http://www.jstor.org/stable/2117851>

Rowland D. (1998) Cyberspace-A Contemporary Utopia? Journal of Information, Law and Technology, 3 (JILT), available at http://www2.warwick.ac.uk/fac/soc/law/elj/jilt/1998_3/rowland/

Rouet, F. (1999) VAT and book policy: impacts and issues (Vol. 1) Council of Europe. p.9

Razin, A., & Sadka, E. (1999). The economics of globalization: policy perspectives from public economics. Cambridge University Press.

Salter, (2001) "Electronic commerce and International Taxation", International Business Law: Electronic commerce and the impact of globalisation on the law, New England Journal of International and Comparative Law Symposium, New England School of Law

Sawyer Adrian J. (1999) 'Electronic Commerce: International Policy Implications for Revenue Authorities and Governments' Virginia Tax Review, Vol 29, 73-112; http://papers.ssrn.com/sol3/papers.cfm?abstract_id=209708

Saxby S. (1995) "A Jurisprudence for Information Technology", <http://www2.echo.lu/legal/en/access/saxby/ch1/ch1.html>

SEHGAL, K. (2004). How Understanding Trust Benefits E-Commerce. London: London School of Economics, Available at http://www.lse.ac.uk/collections/informationSystems/iSChannel/iSChannel2006/Sehgal_2006.pdf

Sen, A. (2010) Adam Smith and the contemporary world. Erasmus Journal for Philosophy and Economics, 3(1), 50-67.

Sharma, V. (2005). Information Technology Law and Practice. Universal Law Publishing., 3rd ed 2011

Seligman, E. R. (1893). The theory of progressive taxation. Political Science Quarterly, 220-251, Vol. 8, No. 2, pp. 220-251

Slemrod, J. (1991). Optimal taxation and optimal tax systems (No. w3038). National Bureau of Economic Research.

Sun, J. (2012). Studies on Impact of Electronic Commerce to Modern Marketing Environment. *Business and Economic Research*, 2(1).

Singh, Nitish, Hadi S. Alhorr, and Boris P. Bartikowski. (2010) "Global electronic commerce: A portal bridging the world markets." *Journal of Electronic Commerce Research* 11.1: 1-5.

Steve Simon, (2012) 'Alexander Hamilton and the Whiskey Tax', Alcohol and Tobacco Tax and Trade Bureau, Regulations & Rulings Division, http://www.ttb.gov/public_info/special_feature.shtml

Strassel A.K. and Schenker J. L, (1998) OECD Summit to Focus on Internet-Tax Collection, Wall St.J. Europe, Sept. 15

Swain & Hellerstein, (2005) The Political Economy of the Streamlined Sales and Use Tax Agreement, *National Tax Journal*

Sweet John K., (1998) Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles, 146 U. Pa. L. Rev. 1949, 1996-97

Tanzi Vito and Zee Howell, (2001) "Tax Policy for Developing Countries," International Monetary Fund, Available at <http://www.imf.org/external/pubs/ft/issues/issues27/index.htm>

Tanzi Vito,(1996) 'Is There a Need for a World Tax Organization', International Institute of Public Finance, Tel-Aviv

Tanzi, Vito (1991) Tax Reform in Economies in Transition: A Brief Introduction to the Main Issues, Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=884657

Terzi Nuray, (2011) The impact of electronic commerce on international trade and employment, *Procedia - Social and Behavioural Sciences*, Volume 24, Pages 745-753, ISSN 1877-0428, 10.1016/j.sbspro.2011.09.010. Available at <http://www.sciencedirect.com/science/article/pii/S1877042811015382>)

Tillinghast, (1996) The Impact of the Internet on the Taxation of Informational Transactions, 50 BULL. INT'L FISC. DOC'N. 524

Traxler, C. (2010). Social norms and conditional cooperative taxpayers. European Journal of Political Economy, 26(1), 89-103

Trotter Hardy, (1994) The Proper Legal Regime for “Cyberspace,” 55 U. PITT. L.REV. 993

Uler Neslihan, (2009), Public goods provision and redistributive taxation, Journal of Public Economics, Volume 93, Issues 3–4, Pages 440-453
(<http://www.sciencedirect.com/science/article/pii/S0047272708001357>)

Ussher, Kitty, (2000) “The spectre of tax harmonisation”, Centre for European Reform. Available at
http://www.cer.org.uk/sites/default/files/publications/attachments/pdf/2011/p165_tax_harmonisation-1974.pdf

Vernon K. Jacobs, Global E-Commerce Taxation: International Tax Issues in Global E-Commerce, Available at <http://www.rpifs.com/ecommerce/ecommercetaxes.htm> (last visited Feb. 21, 2010)

Ward, B. and Sipior, J. (2004) To Tax or Not to Tax Electronic commerce: A United States perspective, Journal of Electronic Commerce Research, VOL. 5, NO.3, Available at <http://www.csulb.edu/web/journals/jecr/issues/20043/Paper3.pdf>

Ward Burke T. & Sipior Janice C. (2011): The Battle Over Electronic commerce Sales Taxes Heats Up, Information Systems Management, 28:4, 321-326

Ward, Sipior, Bremser, McGinty: (2006) A comparison of United States and European union taxation of electronic commerce,
<http://web.sau.edu/LillisKevinM/csci660/2008Fall/papers/WardSipiorBremserMcGinty.pdf>

Wareham A, (2012), Fiscal policies and the institution of a tax state in Anglo-Saxon England within a comparative context, *The Economic History Review*, Volume 65, Issue 3, pages 910–931

Warren, NA, (1998), 'Taxation of internet trade', *Asia Pacific tax bulletin*

Wildavsky Aaron, (1992), "Political Implications of Budget Reform: A Retrospective" *Public Administration Review*, Vol. 52, No. 6 (Nov. - Dec)

Winston J. Maxwell and Thomas P. Newman, (1998) *Electronic Commerce Considered By World Trade Organization: Comprehensive Regulatory Review* Begun, N.Y. L.J., November 16, at S7

Wu, (1997) *Cyberspace Sovereignty? The Internet and the International System*, 10 HARV. J. L. & TECH. 647

Yang, Chang and Xing, (2005) *Current Status of Internet Commerce Taxation*, Yang, *Journal of State Taxation*, Available at http://heinonline.org/HOL/Page?handle=hein.journals/jrnsttax23&div=27&g_sent=1&collection=journal

Zee, (1998) *Taxation of Financial Capital in a globalised environment; the role of withholding taxes*, (*National Tax Journal*, Vol.51-3)

Other sources

OECD (1998) “Electronic Commerce: Taxation Framework Conditions” (A Report by the Committee on Fiscal Affairs, as presented to Ministers at the OECD Ministerial Conference “A Borderless World: Realising the Potential of Electronic Commerce” on 8 October 1998)

<http://www.oecd.org/dataoecd/46/3/1923256.pdf>

OECD, (1999), Ministerial Conference on Electronic Commerce, Available at

<http://www.oecd.org/sti/ieconomy/forumbackgroundtheottawaconference.htm>

OECD (1998), OECD Model Tax Convention and Discussion on its relevance to electronic commerce, Available at

<http://www.oecd.org/tax/treaties/35869032.pdf>

OECD (2000), OECD Model Tax Convention “The Application of the Permanent Establishment Definitions in the Context of Electronic Commerce: Proposed clarification of the Commentary on Article 5 of The OECD Model Tax Convention”, Revised Draft for Comments

OECD, (2001) Understanding the Digital Divide, Available at

<http://www.oecd.org/internet/interneteconomy/1888451.pdf>

OECD (2003), ARTICLES OF THE MODEL CONVENTION WITH RESPECT TO TAXES ON INCOME AND CAPITAL, Available at

<http://www.oecd.org/dataoecd/52/34/1914467.pdf>

OECD (2003), Report on the Implementation of the Ottawa Taxation Framework Conditions, Available at

<http://www.oecd.org/tax/taxadministration/20499630.pdf>

OECD (2006), International VAT/GST Guidelines, Available at

<http://www.oecd.org/ctp/consumptiontax/36177871.pdf>

OECD (2009), Background Report on empowering e-consumers, Washington, Available at <http://www.oecd.org/dataoecd/44/13/44047583.pdf>

OECD (2008), "Shaping Policies for the Future of the Internet Economy", *OECD Digital Economy Papers*, No. 148, OECD Publishing. Available at <http://www.oecd-ilibrary.org/docserver/download/fulltext/5kz83bgb888s.pdf?expires=1336471952&id=id&accname=guest&checksum=BF638A5ABEB9460F78C96FDC8C39AA83>

United Nations Convention on Contracts for the International Sale of Goods (CISG) Available at http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html)

UNCITRAL Model Law on Electronic Commerce, Available at http://www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf

World Trade Organization (2005), Ministerial Declaration of 18 December '05, 46, WT/MIN(05)/DEC, Available at http://www.wto.org/english/thewto_e/minist_e/min05_e/final_annex_e.htm

IMF discussion of the main concerns of tax reform in emerging economies by IMF Working Paper No. 91/23. Available at <http://ssrn.com/abstract=884657>

IMF (2011) Staff Discussion Note, Michael Keen, Mahmood Pradhan, Kenneth Kang, and Ruud de Mooij "Raising the Consumption Tax in Japan: Why, When, How?" June 16, 2011 Available at <http://www.imf.org/external/pubs/ft/sdn/2011/sdn1113.pdf>

Multistate Tax Commission, Public-Private Sector Study of Cost of Collecting State and Local Sales and Use Taxes, Available at <http://www.mtc.gov/Resources.aspx?id=170>

Wyoming Vendor Manual (2007) Compliance through education, State of Wyoming - Department of Revenue - Excise Tax Division, Available at <http://revenue.state.wy.us/PortalVBVS/uploads/Vendor%20Manual.pdf>

Estimated Quarterly U.S. Retail Electronic commerce Sales as a Percent of Total Quarterly Retail Sales: 4th Quarter 1999–3rd Quarter 2009, Available at <http://www.census.gov/retail/mrts/www/data/html/09Q3.html>, November 2009

Quarterly Retail Electronic Commerce Sales 3rd Quarter 2012 FRIDAY – November 2012 Available at http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf

US Treasury Dept Office of Tax Policy, Selected Tax Policy Implications of Global Electronic Commerce (1996), Available at <http://ustreas.gov/offices/tax-policy/library/Internet.pdf>

Selected Tax Policy Implications of Global Electronic Commerce – November 1996, Department of the Treasury Office of Tax Policy, Available at <http://www.treasury.gov/resource-center/tax-policy/Documents/internet.pdf>

Office of Technology and Electronic Commerce (US Dept. of Commerce International Administration) 2009, Available at [http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/\\$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%202016.pdf](http://web.ita.doc.gov/ITI/itiHome.nsf/0657865ce57c168185256cdb007a1f3a/3771d41ba49c5cba852577440056dcd4/$FILE/Electronic%20Commerce%20Industry%20Assessment%20Public%20June%202016.pdf)

Report of the Electronic Expert Group to the Attorney General (Australia), 'Electronic Commerce: Building the Legal Framework', (1998) Available at www.law.gov.au/aghome/advisory/ecag/single.htm

A declaration of the independence of cyberspace, 1996, Available at <https://projects.eff.org/~barlow/Declaration-Final.html>
Internet Corporation for Assigned Names and Numbers, Available at <http://www.icann.org/>

World Bank data, Available at <http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS/countries>

Case C-58/01. *Océ Van der Grinten NV v. Commissioners of Inland Revenue*
<http://curia.europa.eu/juris/showPdf.jsf?jsessionid=9ea7d0f130debc481ae670324aeca429a16d6ca5f4e9.e34KaxiLc3eQc40LaxqMbN4NchuLe0?text=&docid=71483&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=55819>
Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment.
<http://europa.eu/scadplus/leg/en/lvb/l31006.htm>

Maastricht Treaty, Article 99,
http://www.ecb.int/ecb/legal/pdf/maastricht_en.pdf

Directive 97/7/EC, Distance Selling Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997L0007:EN:NOT>

Tax Coordination in the European Union, Working Paper, 2000,
http://www.europarl.europa.eu/workingpapers/econ/pdf/125_en.pdf

European Union, Press Release No. 5/02, 13th February 2002,
www.eurunion.org/news/press/2002.htm

EU Tax on Digitally Delivered Electronic commerce, 2005, Congressional Research Service Report for Congress
http://ipmall.info/hosted_resources/crs/RS21596_050407.pdf (September 2010)

Council Directive 2006/112/EC, VAT Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0112:20110101:EN:PDF>

Press release (IP/08/208) (VAT package: Commission welcomes adoption by the ECOFIN Council of new rules on the place of supply of services and a new procedure for VAT refunds - Reference: IP/08/208 Date: 12/02/2008)
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/208&format=HTML&aged=0&language=en&guiLanguage=en>

Accelerating Electronic commerce: EU Actions, at
http://europa.eu.int/information_society/

eeurope/action_plan/stimulatelecommerceeu/targets_2000/index_en.htm. See also Communication From the Commission to the Council and the European Parliament: Electronic commerce and Financial Services, COM (2001) final at 2, at http://europa.eu.int/comm/internal_market/en/finances/general/ecom_en.pdf; A European Initiative in Electronic Commerce: Communication to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, COM(97)157 at 4, at <http://www.cordis.lu/esprit/src/ecomcom.htm>

EUROPA (2006) "How VAT works?" – "FAQ", http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/e-services/article_1610_en.htm

European online commerce will develop in 2010 Online shopping growths 20% while overall retail sales only increased by 1.4%, Published February 10, 2010 by PressDK in <http://presse.kelkoo.dk/europ%25C3%25A6isk-online-handel-vender-udviklingen-i-2010-online-shopping-v%25C3%25A6kster-20-mens-den-overordnede-detailhandel-kun-stiger-med-14.html> (March 2011)

COMMISSION STAFF WORKING DOCUMENT: Report on cross-border electronic commerce in the EU

February 2009,

http://ec.europa.eu/consumers/strategy/docs/com_staff_wp2009_en.pdf

Information and Communication Technologies, 19 January 2010,

http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/4-19012010-BP/EN/4-19012010-BP-EN.PDF

Eurostat, Main national accounts tax aggregates, Last update: 29-11-2012,

http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_a_tax_ag&lang=en

Taxation trends in the European Union, 2012 Edition,
http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2012/booklet.pdf

Reuters (2002) “Europe Approves Net Tax Law”, May 7,
www.wired.com/news/print/0,1294,53351,00.html

Egypt cuts off internet access,
<http://www.guardian.co.uk/technology/2011/jan/28/egypt-cuts-off-internet-access>

HMRC targets EBay tax dodgers,
<http://www.telegraph.co.uk/finance/yourbusiness/8573216/HMRC-targets-eBay-tax-dodgers.html>

VAT rates,
http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/,
Turnover from electronic commerce broken down by web and EDI type sales,
2010, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Electronic_commerce_statistics
Federation of Tax Administrators at
http://www.taxadmin.org/fta/pub/services/online/default_07.html

Ernst & Young , 2012 , *Worldwide VAT, GST and Sales Tax Guide* (available at
[http://www.ey.com/Publication/vwLUAssets/2013-worldwide-VAT-GST-and-sales-tax-guide/\\$File/2013-worldwide-VAT-GST-and-sales-tax-guide.pdf](http://www.ey.com/Publication/vwLUAssets/2013-worldwide-VAT-GST-and-sales-tax-guide/$File/2013-worldwide-VAT-GST-and-sales-tax-guide.pdf))

EBay traders on the HMRC spotlight,
<http://www.guardian.co.uk/money/2012/may/01/ebay-traders-hmrc-tax-spotlight>
Europe Approves Net Tax Law, Reuters (2002) ,
<http://www.wired.com/news/print/0,1294,52351,00.html> ,/

US not happy about EU Tax, J. Glasner, 2002,
<http://www.wired.com/news/print/0,1294,52378,00.html>
